

# Economic Expansion in 1965

IN 1965, the American economy set records in production, sales, employment, income, and living standards, as the expansion that started in early 1961 was extended for the fifth year in a row. Most broad measures of economic activity showed impressive gains, which exceeded even the large advances of 1964 and surpassed by a wide margin the expectations for 1965 held early in the year by most businessmen and economic forecasters. Demand increased in most final markets and was especially strong for business fixed investment and consumption expenditures, notably durable goods.

Within the year, the advance in total output and sales was uninterrupted but somewhat irregular. In the early months of 1965, increases were unusually large as the economy recovered from the depressing effects of the automobile strikes of late 1964. Gains moderated in the spring months but accelerated after midyear under the influence of sharply rising capital outlays, the cut in excise taxes, the increase in Social Security payments in early fall, and particularly the step-up in defense expenditures that resulted from the increase in the fighting in Vietnam.

Prices rose somewhat more from 1964 to 1965 than in the other years of the current expansion, but for the year as a whole, the rise over 1964, as indicated by the comprehensive GNP deflator, could still be characterized as moderate. The most prominent price increases occurred in the first half of the year, for farm products and for food products at both wholesale and retail levels. Wholesale industrial prices rose in each quarter of 1965

and for the first time since 1959 showed a modest but noticeable increase for the full year; consumer prices rose somewhat more in 1965 than the year before. The cost of credit also moved up as the demand for borrowed funds

advanced even more rapidly than the substantially increased supply of credit.

Although the Nation's capacity to produce was considerably enlarged in 1965, the rise in output was still greater, and the gap between potential and actual output was lower than at any other time in the current expansion. Despite a large increase in the labor force, employment rose even more; unemployment declined steadily, and by yearend was close to the Administration's interim goal of a 4-percent unemployment rate. Unemployment rates were still high for teenagers and Negroes, but toward the end of the year, labor shortages were not uncommon in some occupations and industries. Even though businessmen made record capital outlays to expand and modernize their plant facilities, the utilization of manufacturing capacity increased and for the full year was about as high as it was in 1955.

Perhaps the outstanding development in 1965 was the change in the economic climate that emerged around the end of the year. It reflected the buoyant state of demand, the prospective large increases in spending, particularly for defense, and the growing pinch on resources. It was a dramatic shift from the spring months, when there was a widespread belief that the expansion might be slowing down. As the year came to a close, a basic question was whether the Nation's capacity to produce could accommodate the anticipated increase in aggregate demand with the moderate price increases that have thus far distinguished the 5-year expansion.

Table 1.—Key Economic Measures, 1962-65

	1962	1963	1964	1965 <sup>1</sup>
Gross national product...bil. \$.	580.3	589.2	628.7	675.6
Personal consumption expenditures...bil. \$.	355.1	373.9	396.9	426.6
Gross private domestic investment...bil. \$.	53.0	55.9	62.9	104.9
Net exports of goods and services...bil. \$.	5.1	6.9	8.6	7.3
Government purchases...do.	117.1	122.6	128.4	135.0
Gross national product in constant (1959) dollars...bil. \$.	580.0	580.0	577.0	609.0
National income...do.	457.7	481.1	514.4	554.6
Compensation of employees...bil. \$.	323.6	341.0	365.3	391.9
Corporate profits...do.	85.7	85.1	84.5	75.1
All other...do.	78.4	82.0	84.6	87.6
Personal income...do.	442.6	464.8	495.0	530.7
Disposable personal income...bil. \$.	384.3	403.8	435.8	465.3
Disposable personal income in constant (1959) dollars...bil. \$.	387.8	389.0	406.5	438.1
Retail sales...do.	235.4	246.4	261.0	282.7
Dealers' sales of new domestic cars...thous.	6,783	7,334	7,617	8,769
Expenditures for new plant and equipment...bil. \$.	37.3	39.2	44.5	51.8
Total construction...do.	59.0	63.8	65.8	68.1
Private nonfarm housing starts...thous. units.	1,439	1,592	1,630	1,481
Manufacturers' sales...bil. \$.	399.7	417.2	445.0	483.0
Industrial production 1957-59=100.	118.2	124.3	122.8	143.8
Steel ingot production...mil. tons.	95.3	109.2	127.1	131.2
Motor vehicles, factory sales...thous. units.	8,172	9,100	9,292	11,081
Employees in nonfarm establishments...thous.	56,516	56,602	58,156	60,422
Unemployed persons...do.	4,007	4,166	3,870	3,486
Consumer prices...1967-69=100.	105.4	106.7	106.1	109.8
Wholesale prices...do.	100.6	100.8	100.5	102.5
Loans and investments of commercial banks, end of period...bil. \$.	228.3	244.3	267.2	284.0
Consumer installment credit outstanding, end of period...bil. \$.	48.0	52.7	59.4	66.0

<sup>1</sup> Preliminary.

<sup>2</sup> End of November.

Sources: Automobile Manufacturers Association, American Iron and Steel Institute, and U.S. Government.

### Government policies

Economic activity during the year was influenced in many different ways—apart from the rise in defense programs late in the year—by Government policies adopted both during and before 1965. The 1964 reduction in personal and corporate income taxes continued to stimulate personal consumption expenditures and business spending on new plant and equipment, and the cut in corporate taxes at the beginning of 1965 provided a further stimulus to business investment. The reduction in excise taxes around midyear lowered prices on a wide variety of consumer goods and provided an additional fillip to consumer spending. Personal income was directly increased by the rise in Social Security benefits. Some of the rise in employment, notably among teenagers, was a reflection of special Government programs associated with the war on poverty. Under the wage and price guidelines, the Government increased pressures against excessive wage and price increases in particular industries. A significant part of the reduction in the balance of payments deficit was a result of the Administration's voluntary program aimed at lowering private capital outflows.

The Federal Reserve permitted a record expansion in bank credit in 1965 but exerted moderate pressure on bank reserves during the year. In December, Reserve authorities raised the discount rate by one-half of 1 percent and permitted member commercial banks to pay up to 5½ percent on time deposits held more than 30 days.

### Yearend Position and Outlook

Total production and sales showed a large increase in the closing months of the year. According to preliminary data, fourth quarter GNP was up \$13 billion (annual rate) over the third quarter. Among the major markets, the most noteworthy development was the large advance in government purchases—more than \$4 billion—about half of which represented increased outlays for defense, particularly military pay.

Personal consumption expenditures continued their vigorous rise with a fourth quarter gain of about \$7½ billion; the change in durable goods purchases, however, was very small. The strong expansion in business fixed investment continued with an increase of almost \$2 billion, but investment in residential structures edged down for the second successive quarter.

Activity rose rapidly throughout the fourth quarter. In December, personal income increased by \$4½ billion over November and reached a seasonally adjusted annual rate of more than \$550 billion. Payrolls rose in most industries as employment and rates of pay increased; hours of work continued unchanged at peak postwar levels.

The December rise in employment in nonfarm establishments was close to 400,000, after seasonal adjustment, two-thirds larger than the average monthly increase since December 1964. Unemployment showed another improvement, and the unemployment rate fell to 4.1 percent of the labor force. The unemployment rate for married men, at 1.8 percent, was the lowest since 1953.

Industrial production in December increased over a broad range of indus-

tries and on an overall basis rose almost 1½ percent, after seasonal adjustment. One feature of the month was the pickup in steel output after 4 straight months of decline. The steel industry seems to be preparing for a resurgence of steel demand in the near future and is apparently building up its own inventories. Stocks of steel held by steel consumers have been cut sharply since September; with consumption moving higher, the inventory adjustment by steel users seems to be moving rapidly toward completion.

Holiday trade appeared to be very buoyant, and retail sales showed a good-sized increase over November, according to advance reports.

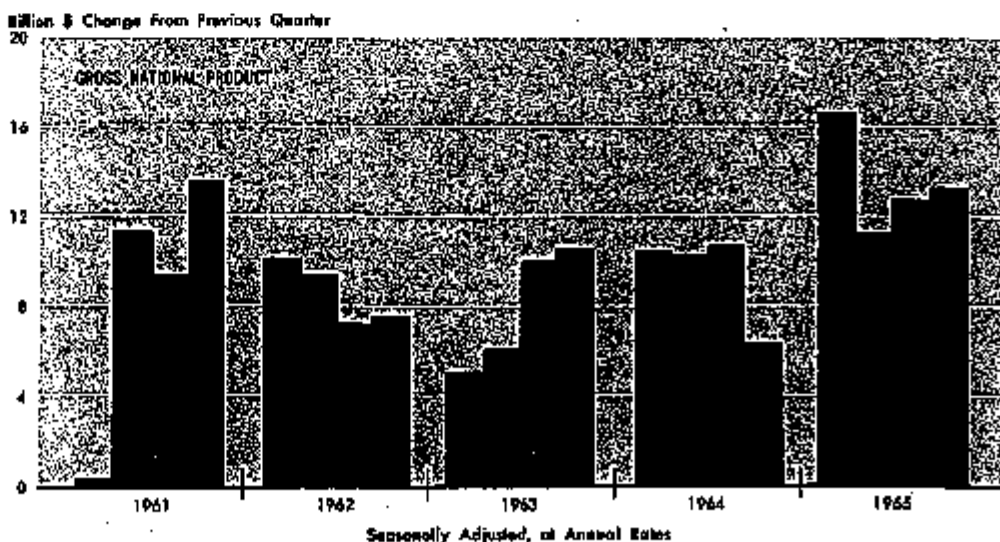
Wholesale prices in December rose 0.6 percent over November because of large increases in the prices of farm and food products. Industrial prices were unchanged over the month.

### Outlook for 1966

At no other time since the start of the expansion did prospects for rising output in the year ahead appear so certain as they did at the end of 1965. With a resolution of the Vietnam con-

(Continued on page 12)

GNP Showed Large Increases in Each Quarter of 1965



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86-1

# National Income and Product in 1965

GROSS national product rose \$47 billion or 7½ percent in 1965 to a total of \$675½ billion. This vigorous advance was one of the largest on record and brought the Nation's economic expansion since the last recession to 5 years, the longest since the end of World War II. Despite the large increase in demand, prices rose only 1½ percent, slightly more than the advance in 1964 and other recent years. The increase in the physical volume of production was 5½ percent, better than the previous year's gain of 5 percent and considerably above the postwar average annual growth rate.

Last year's advance in real output was exceeded in only 5 other postwar years—1950, 1951, 1955, 1959, and 1962. Except for 1951, the large gains in output in these years reflected the sharp expansion typical of recoveries from business recessions. In 1951, output was boosted by very heavy defense expenditures associated with the Korean war. In contrast, the 1965 advance followed a long period of expansion, and production for the full year was little affected by expanding military outlays.

Within the year, the largest increases in GNP came in the first and fourth quarters, although advances in the other quarters were also sizable. In the first quarter, GNP rose by the unusually large amount of \$16½ billion at a seasonally adjusted annual rate, mainly because automobile sales and production made a strong recovery from the auto strikes in the fourth quarter of 1964. The above-average rise in fourth quarter output stemmed from an acceleration in defense spend-

ing superimposed upon continuing large gains in consumer spending and business fixed investment.

## Private spending dominates advance

Most major GNP categories rose substantially in 1965. The relative rise in business investment was the sharpest; the rise in consumption about equaled the overall rate of advance in GNP,

and the rise in Government spending fell somewhat below the overall advance in production (chart 2).

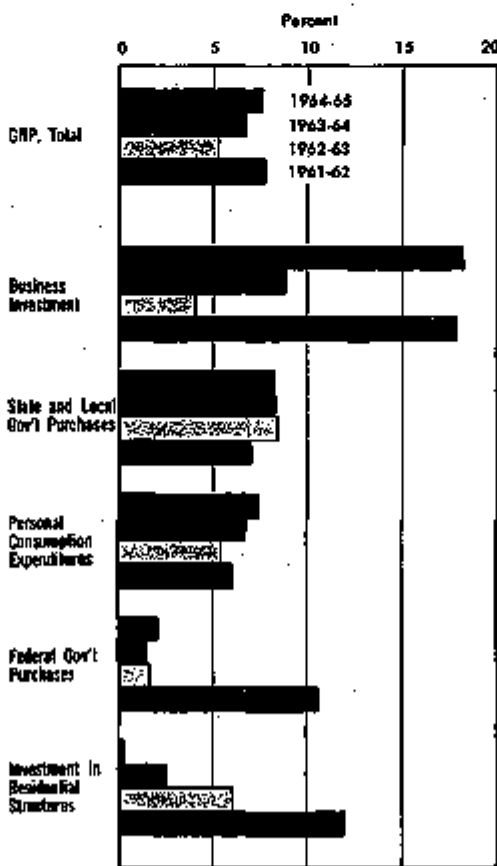
Last year, like 1964, was a year of buoyant consumer demand. Consumer expenditures for all major categories of goods and services, especially autos and food, rose substantially, and the total increased \$29½ billion to a record \$428½ billion. The 7½-percent increase over 1964 exceeded the relative gain in disposable personal income and the saving rate fell.

Outlays for new capacity, replacement, and cost-cutting raised business fixed investment \$9½ billion or 15½ percent to an annual total of \$69½ billion. The share of real GNP devoted to such investment was 10½ percent, the highest since 1957. Outlays for both equipment and structures increased substantially and investment rose sizably in each quarter.

With further declines in apartment house building and little change in single family home construction, expenditure on residential structures, at \$27½ billion, was virtually unchanged from 1964 in current dollars and lower in real terms. Residential investment increased moderately during the first half of 1965 but declined during the second.

Nonfarm inventory investment in 1965 was \$7 billion, a rise of \$1½ billion over 1964. The peak in inventory accumulation was reached in the first quarter, when special factors helped boost accumulation to an annual rate of over \$9 billion. Inventory buying tended to slacken thereafter, ranging from \$6 billion to \$7 billion.

CHART 2  
Percent Changes in Gross National Product



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28-12

Farm inventories showed a small increase in 1965 after a decline in 1964.

Imports rose more than exports in 1965, and net exports, at \$7½ billion, were off \$1½ billion from the 1964 pace. Because of the dock strikes, imports and especially exports fell during the first quarter of 1965. Both made strong recoveries in the spring and, after changing little in the summer, rose again in the final quarter.

An increase in nondefense spending was responsible for last year's \$1½ billion rise in Federal Government purchases of goods and services, which totaled \$66½ billion. From 1964 to 1965, defense purchases were unchanged, even though military spending moved up in the last quarter of 1965. State and local government purchases, continuing their long uptrend, rose 8 percent or \$5 billion to a total of \$68½ billion.

#### *Spurt in profits*

National income rose 7½ percent to a total of \$554½ billion last year, according to preliminary data. All major income categories moved up, the largest relative gains being scored by farm income and corporate profits.

Corporate profits increased \$8½ billion, the sharpest calendar-year gain since the rise in 1959. Proprietors' income increased by \$3½ billion; two-thirds of this reflected a gain in farm proprietors' income, attributable mainly to the rise in farm prices. Higher employment and average annual earnings helped boost employee compensation \$26½ billion.

Increases in profits and farm proprietors' income were most marked in the first half of last year. During the second half, employee compensation accounted for a much larger share of the national income rise.

### **Income, Consumption, and Saving**

THE strong advance in economic activity in 1965 was accompanied by the largest year-to-year absolute increase in personal income since World War II. The 1965 total of \$531 billion was \$36 billion or 7½ percent above

1964. The large flow of income from production was boosted by the increase of 7 percent in social security benefits that began in October after a lump-sum disbursement of \$885 million in September for payments retroactive to January 1965. Thus, personal transfer payments, which rose \$1½ billion in 1964, were up \$2½ billion in 1965.

As a result of these special factors, quarterly movements in personal income were not uniform during the year. The largest quarterly rise—\$11 billion at an annual rate—occurred in the third quarter, when the retroactive social security payments were made.

#### *Large rise in disposable income*

Because of the underwithholding of Federal taxes on personal income in 1964—the withholding rate was cut to

14 percent as a result of the new law even though the 1964 rate for the lowest tax bracket was reduced to 16 percent—final net settlements early in 1965 were higher than normal, and Federal personal taxes rose sharply in the first half of the year. A moderate reduction followed in the second half. For 1965 as a whole, Federal personal taxes totaled \$54 billion, a rise of \$5 billion over 1964. These taxes took 10.2 percent of personal income in 1965, a slight increase over the 9.3 percent in 1964. In the immediate pre-tax-cut years, 1961–63, the ratios were 10.7, 11.0, and 11.1 percent respectively (chart 3).

State and local personal taxes in 1965 amounted to \$11½ billion, about \$1 billion more than in 1964. These taxes now take 2.2 percent of personal income, having shown a slightly rising tendency over the past several years; in 1961, the ratio was 1.8 percent.

Because of the large final net settlements on Federal taxes in the first half of 1965, the advance in disposable personal income was somewhat dampened. However, the total for the year was up 6½ percent over 1964 and, at \$465 billion, set another record. Real per capita disposable personal income—which takes into account the growth in population and the advance in consumer prices—was 5 percent above 1964.

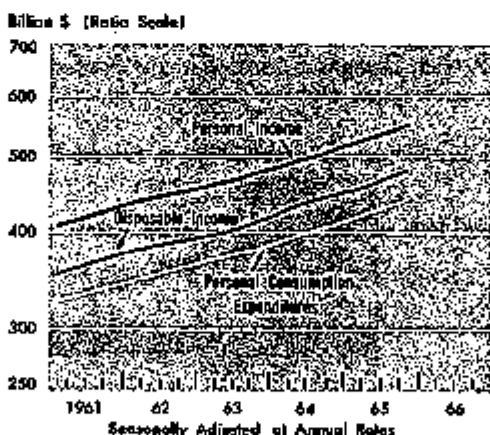
#### *Consumers spend at record rate*

Consumers spent freely on all types of goods and services in 1965, as their incomes rose and they made extensive use of consumer credit. Even after allowing for the moderately higher consumer prices, the rise in real expenditures was an impressive 5 percent.

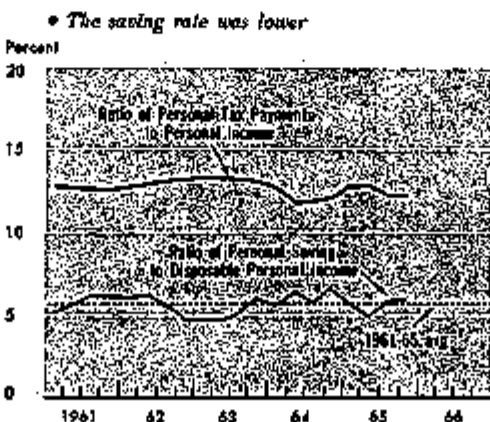
Auto purchases in 1965 showed the sharpest gain among the major expenditure groups (chart 4). Unit sales to all categories of buyers posted a new record of 9.3 million cars, of which about 500,000 were imported and 8.8 million were domestically produced. The excellent performance in 1965 followed a year of strong auto sales; 8.1 million cars were sold in 1964.

Although auto buying last year reflected some makeup of sales lost because of the auto strikes in October

CHART 3  
**Consumer Income and Spending  
Registered Large Gains in 1965**



\* The take of taxes out of personal income was somewhat higher than in 1964.



and November of 1964, that was not a major factor. In both 1964 and 1965, auto purchases reflected the large expansion in after-tax income. After May 1965, sales were also boosted by the reduction of the auto excise tax from 10 to 7 percent.

Purchases of durable goods other than autos and parts—i.e., furniture and household equipment, jewelry, books, etc.—depend to a large extent on changes in income, and 1965 was no exception. Spending on these items in the aggregate was up 6 percent over 1964, as compared with a 3½-percent rise in disposable personal income. Furniture and household equipment expenditures rose only 5 percent, reflecting in part the lag in residential housing sales. Spending for the other durable goods items increased 9 percent over 1964.

#### *Nondurables reflect income rise*

Throughout the postwar period, consumer expenditures for nondurable goods, which include the large categories of food and clothing, have moved in close relationship to disposable income. The 6½ percent increase in spending on nondurable goods in 1965 was about the same as the rise in disposable personal income.

Food and clothing purchases, which comprise 70 percent of total spending for nondurable goods, rose 6½ and 5½ percent respectively in 1965; expenditures for gasoline and oil rose 4½ percent, and outlays for all other types of nondurables, 8½ percent. Spending for food and beverages increased steadily throughout the year, partly because of higher retail food prices, which advanced by more than 2 percent over 1964. In the fourth quarter of last year, expenditures for food and beverages topped the \$100 billion annual rate for the first time, for an average per capita outlay of about \$520.

#### *Services continue to grow*

Consumers spent about \$175 billion for services in 1965, an increase of 7½ percent over 1964. After allowance for the 2½-percent rise in service prices in 1965, the increase over 1964 came to 5½ percent in real terms.

Of the major groups of services, housing expenditures showed the larg-

est current dollar advance in 1965—about 9 percent. The increase in expenditures for transportation services—4 percent—was much less than the rise in disposable personal income; this fact reflects the growing use of private automobiles at the expense of public transportation. Total expenditures for the other groups of services—medical care, personal business, etc.—advanced somewhat more than disposable income.

The ratio of expenditures for services to disposable personal income was 37½ percent in 1965. Throughout most of the postwar period, consumers have devoted an increasing proportion of their income to services. By 1960, the ratio had reached nearly 37 percent,

for the first time exceeding the high of 36½ percent recorded in 1929. Since 1962, the ratio has fluctuated within a narrow range around 37½ percent, representing at least a temporary halt in the steady rise in the portion of income spent on services.

#### *Personal saving rate lower*

Consumers saved about \$25 billion, or 5.4 percent, of their disposable personal income in 1965. Over the past decade, personal saving as a percent of disposable personal income has fluctuated from a high of 7.0 percent in 1956 to a low of 4.9 percent in 1960. From 1955 to 1964, the average annual rate was 6.0 percent (chart 3). In 1964, the saving rate was at this average; in 1965, the volume of saving as well as the rate of saving was lower than in 1964. The saving rate is, in part, a function of consumer purchases of durable goods, especially autos. From 1964 to 1965, expenditures on consumer durable goods rose from 13½ percent of disposable income to 14 percent—an increase only slightly less than the decline in the saving rate. In the fourth quarter of 1964, the drop in auto sales due to the strikes in that period was a factor in the rise in the saving rate to 6.6 percent from the 5.7 percent in the preceding quarter. Following the sharp pickup in auto sales in the first half of 1965, the saving rate fell to about 5 percent. Auto sales continued at high rates in the second half of 1965, and saving remained below 6 percent of disposable income.

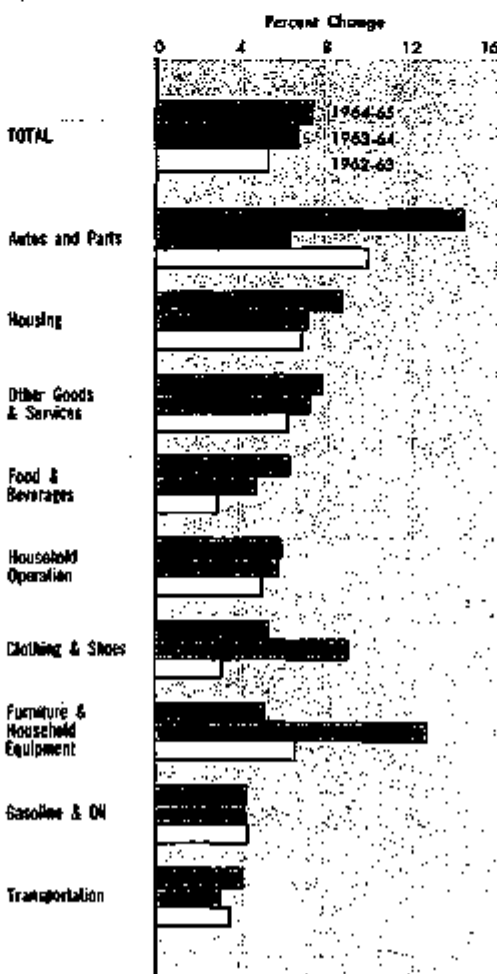
Another factor that may have affected the saving rate in 1965 was the increased flow of income in the form of transfer payments, a larger proportion of which is probably spent than is the case with most other types of income, since most of these payments go to low income groups—the unemployed and those living on social security benefits. The abnormally high income tax settlements in the first half of 1965 may also have contributed to the reduction in the rate.

#### *Business Fixed Investment*

Business investment in plant and equipment rose substantially through-

CHART 4  
**Personal Consumption Expenditures**

*Autos and parts recorded the sharpest gain in 1965 among the major groups*



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out 1965 and totaled \$69½ billion for the year as a whole, \$9¼ billion or 15½ percent above 1964. This rise, like the 11-percent rise from 1963 to 1964, outpaced the relative increases in consumption and government expenditures; in the earlier years of the current expansion, investment about kept pace with the rise in overall activity.

Expenditures for both 'producers' durable equipment and nonresidential structures advanced relatively more from 1964 to 1965 than they had the previous year. After a modest increase in 1964, investment in structures rose substantially in 1965 and apparently reflected increased emphasis on capacity expansion as against replacement and modernization. The acceleration occurred in expenditures for industrial and commercial facilities; in both 1964 and 1965, public utility construction rose moderately, and farm construction declined slightly.

Rising investment during the year reflected many influences—steadily increasing sales and unfilled orders, high and rising rates of capacity utilization, and a large advance in before-tax profits. Cash flow also rose, in part because of a liberalization of the depreciation rules and the second stage of the income tax cut.

Businessmen started the year 1965 with high investment programs and, in the first three quarters of the year, spent even more than they had anticipated. This suggests that the stimulants to investment were stronger than had been expected earlier. In this connection, it may be noted that manufacturing and trade sales each rose about 8 percent from 1964 to 1965; in early 1965, businessmen reported expected gains of 5 to 6 percent over 1964.

The forces stimulating capital goods demand appeared to have lost little or none of their strength as 1965 drew to a close—although further increases in interest rates may have a restraining influence on some marginal investments. Investment in the fourth quarter was at a seasonally adjusted annual rate of over \$72 billion, and businessmen in virtually every major industry anticipated further sizable advances through at least mid-1966. An exceptionally large and growing volume of plant and

equipment projects underway also buttressed the near-term demand for capital goods.

### Investment by industries

Although the expansion in investment in 1965 was sizable in all industrial sectors, the rise in manufacturing was especially large (chart 5). Outlays for new plant and equipment by manufacturers were more than one-fifth higher in 1965 than in 1964, having increased 18 percent in the preceding year. Investment by nonmanufactur-

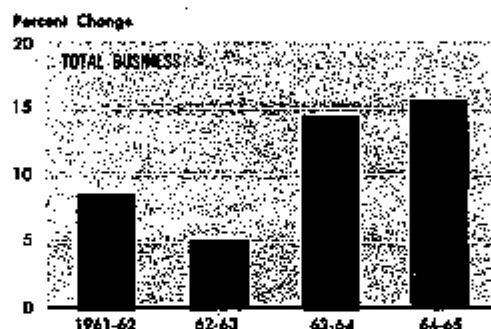
ing companies as a whole was up by more than one-tenth in 1965, about the same as the increase in 1964. Among the highlights in the nonmanufacturing sector during 1965 were the resurgence of capital spending by the airlines and the continued large expansion by the railroads; these lifted expenditures for new plant and equipment by the transportation group to one-fifth above the 1964 total. The utilities and mining and communications firms showed increases of about 10 percent.

Within manufacturing, both the durable and the nondurable goods groups enlarged their capital outlays more than 20 percent in 1965, with every component industry contributing to the advance. For the heavy goods industries, the rise was about the same as in the previous year. Soft goods investment rose somewhat more in 1965 than in 1964 largely because of the accelerated programs of textile, chemicals, and rubber producers. These three industries, and the motor vehicle, nonelectrical machinery, and nonferrous metals industries in the durables group, all increased their outlays by 30 percent or more in 1965.

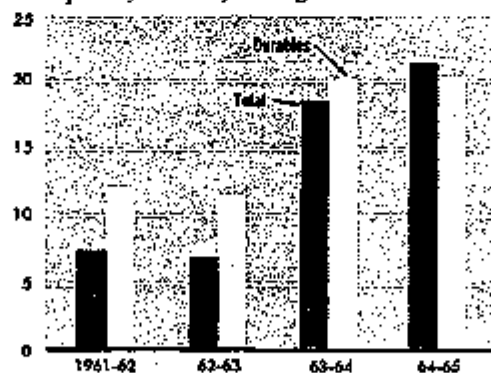
Despite the sizable expansion in manufacturers' capital expenditures and capacity in 1965, demand was such that a rising number of producers in a broad range of industries felt that their existing facilities were inadequate. At the end of September 1965, manufacturers holding about one-half of total gross capital assets in manufacturing reported that they needed more plant and equipment facilities to meet their production requirements in the next 12 months—as compared with 39 percent a year earlier.

Consistent with this evaluation of growing capacity needs was an upward trend during the year in the aggregate value of new projects started. In virtually all industries, the value of "starts" exceeded outlays each quarter; this brought about a widespread increase in the carryover of expenditures yet to be made on projects underway. On September 30, 1965, manufacturers reported a carryover of new investment projects of \$16.2 billion, 37 percent above the total in September 1964.

CHART 5  
Expenditures for New Plant and Equipment  
Showed a Large Rise in 1965



Especially in manufacturing...



Where a rising proportion of firms have indicated a need for more capacity



\* Held by Manufacturers indicating need for more capacity in next 12 months.



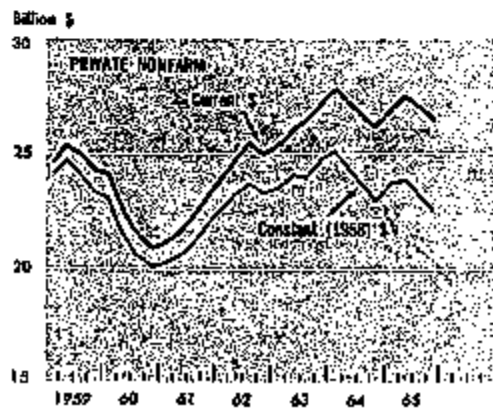
## Residential Construction

Residential building was the only major component of private domestic investment that did not show a real increase in 1965. Investment in private nonfarm residential structures, at \$27 billion in current dollars, changed little from 1964; constant dollar expenditures were 3 percent lower than in 1964. Seasonally adjusted outlays rose moderately in the first quarter of 1965 and slightly further in the second, but declined after midyear. On a constant dollar basis, fourth quarter 1965 outlays were about 10 percent below the peak reached at the beginning of 1964.

The decrease in the real volume of housing expenditures reflected a 3-percent decline in the number of private nonfarm housing starts, which was offset by a small increase in average value per unit. Starts totaled 1.48 million units in 1965, as compared with 1.53 million the year before and 1.58 million in 1963, the recent peak. Average value per unit in 1965 rose (after allowing for the rise in construction costs) because the product mix included a greater proportion of single family homes, which are more costly per unit than apartments, and homebuilders continued to upgrade to the larger and more expensive types of single family residences.

### Residential Construction Activity

- Current dollar expenditures in 1965 were close to the 1964 total
- Real volume was lower



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96-14

## Multifamily construction declines

From 1960 through 1964, single family housing starts remained within a fairly narrow range of 945,000 to 995,000 units per year. During the same period, multifamily starts more than doubled, from a little over 250,000 units to nearly 600,000 in both 1963 and 1964. The great rush by builders to capitalize on the shift toward apartment living led to considerable overbuilding and increased vacancy rates in a number of the major metropolitan areas in late 1963 and early 1964, which marked the peak of the apartment house boom.

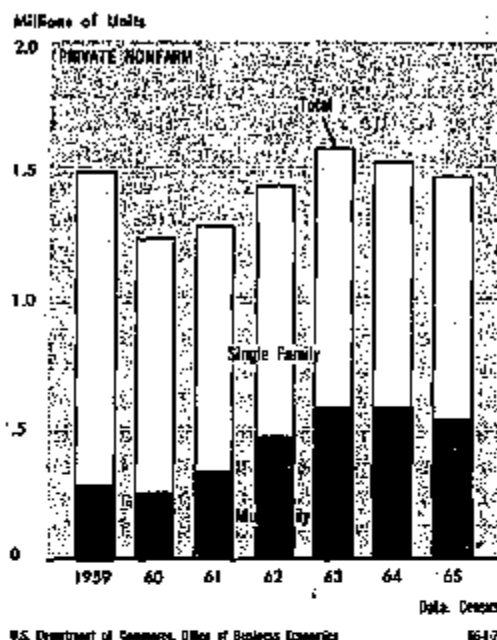
In 1965, single family starts were only a little under the 1964 total, but apartment building, although still very high by past standards, declined nearly 50,000 units, or more than 7½ percent. The decline in apartment house construction appears to have been related to the continued existence of high vacancy rates in those areas where multifamily construction had been especially active after 1960.

### Sharp cutback in the West

There were divergent regional trends in the volume of housing starts last year. As in 1964, most of the reduction in starts occurred in the Western States. In this region, starts dropped to 280,000 units, down nearly one-fourth from the 1964 total and far below the 430,000 units started in 1963. The severity of the cutback in the West is illustrated by the fact that units begun in 1965 were nearly one-tenth under the previous low of 310,000 in 1960.

In both the Northeast and North Central regions, where economic activity has been especially buoyant because of rising durable goods production, starts rose about 25,000 units, or 9 percent and 7 percent respectively. The gain in the North Central region was the fourth successive annual rise and boosted starts more than one-third from their recent low in 1961. In the South, the region with the largest number of units begun, starts held close to 570,000 units for the third straight year.

## Housing Starts Drift Down Again in 1965



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96-17

## Rise in mortgage rates at yearend

Funds for home construction and purchase were generally ample in 1965, as they were in the previous years of the current expansion. After midyear, yields on FHA mortgages began to edge up, but interest rates on conventional mortgages continued to be stable. Following the increase in the discount rate early in December, interest rates on mortgages rose considerably and the financing of housing appeared less favorable than at any other time in the past 5 years.

## Inventory Investment

Apart from the early recovery period, the behavior of inventories during the economic expansion of the 1960's has been quite different from that in previous postwar expansions. In the previous expansions, stocks tended to increase relative to production after the first year or year and a half of the overall economic advance. In contrast, since the end of the early recovery phase in late 1961-early 1962, the level of inventories has shown comparatively little change in relation to total output. Last year was no

exception even though inventory accumulation was somewhat higher than in the other years of the current expansion. Through the end of 1965 the ratio of nonfarm stocks to GNP (based on constant dollars) held fairly close to the 21½ percent ratio that has prevailed since the fourth quarter of 1961. Moreover, with few exceptions, stocks in individual industries have not appeared excessive in relation to sales.

#### Durable goods increase

Investment in nonfarm inventories totaled about \$7 billion last year as compared with a rate of \$5½ billion in 1964. Manufacturing and trade firms in durable goods accounted for most of last year's accumulation and for all of the increase in accumulation from 1964 to 1965. Inventory investment in nondurable lines decreased from 1964 to 1965.

As compared with 1964, there was a modest rise last year in accumulation by durable goods manufacturers; this reflected primarily increased production requirements in a broad range of metal-fabricating industries. Accumulation by trade firms—notably retailers—in durable goods lines also increased from 1964 to 1965. Much of this advance was accounted for by automotive dealers whose stocks at

yearend appeared high in relation to sales, judged by the experience of recent years.

#### Accumulation at peak in first quarter

Inventory investment (nonfarm) showed considerable variation during 1965. It surged to a seasonally adjusted annual rate of \$9 billion in the opening quarter of last year, after a substantial increase toward the end of 1964, and declined to a range of \$6 billion to \$7 billion in the remaining quarters of 1965.

Special factors were responsible for the bulge in inventory buying early in 1965; their disappearance helped to moderate the pace of accumulation later on. In the first and second quarters of last year, auto dealers replenished their inventories after the depletion caused by strikes in the final quarter of 1964. The dockworkers' strike had the effect in the first quarter of temporarily building up inventories of goods that normally would have been shipped out.

Steel stocks showed a considerable swing during 1965. Late in 1964, steel consumers and warehouses began to build up their stocks as a hedge against the possibility of a strike in the steel industry. Accumulation continued through the third quarter of 1965 but gave way to liquidation in the final quarter after agreement was reached on a new labor contract in September.

(exclusive of Federal grants-in-aid) were up \$4½ billion.

#### Shift in Federal fiscal position

These movements in expenditures and receipts resulted in a sharp improvement in the Federal fiscal position: For State and local governments, the excess of receipts over expenditures was unchanged from a year earlier.

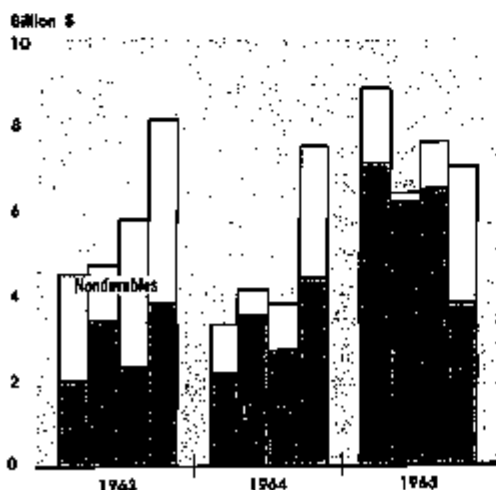
Because of the marked changes in Federal tax and expenditure patterns during the course of 1965, semiannual comparisons are more revealing than annual comparisons about the major shifts in the Federal fiscal position. In the first half of 1965, Federal expenditures were almost \$2½ billion higher (annual rate) than in the preceding half-year. Federal receipts over the same period rose nearly \$8½ billion. These changes gave rise to a surplus of over \$3½ billion, as compared with a deficit of \$2½ billion in the second half of 1964.

In the latter half of 1965, however, expenditures spurted by \$6 billion (annual rate), reflecting mainly the step-up in defense outlays and the expanded volume of transfer payments under the Social Security Amendments of 1965. Receipts were virtually unchanged from the first half so that on

CHART 8

#### Change in Business Inventories (GNP Basis)

- Was larger in 1965 than in 1963 and 1964
- Accumulation was at a peak in first quarter



Quarterly, Seasonally Adjusted, at Annual Rates  
U.S. Department of Commerce, Office of Business Economics 66-14

#### Government Expenditures and Receipts

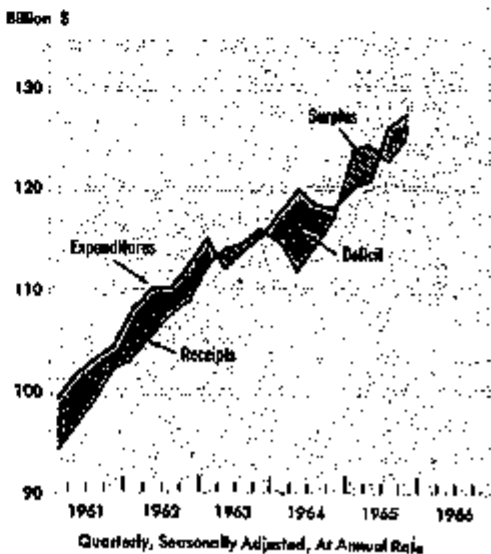
TOTAL government purchases of goods and services increased \$6½ billion from 1964 to 1965. State and local purchases again accounted for the bulk of the rise; Federal purchases, which rose only modestly for the full year, began to show the impact of Vietnam in the second half of 1965.

Total expenditures by all levels of government, including transfer payments, subsidies, and interest, as well as purchases, rose \$10½ billion.

Tax receipts and social insurance contributions moved up sharply as rising business activity lifted tax bases: Federal receipts rose \$9½ billion, in spite of the important tax cuts, and State and local government receipts

CHART 9

#### Federal Government Receipts and Expenditures



Quarterly, Seasonally Adjusted, at Annual Rates  
Note: Based on national income and product accounts.  
U.S. Department of Commerce, Office of Business Economics 66-15



balance a deficit of \$2½ billion (annual rate) was incurred.

### Small rise in Federal purchases

Since 1962, changes in Federal purchases of goods and services have been relatively small. Federal fiscal policy has been aimed at stimulating private demand, primarily through tax reduction; on the expenditure side, new programs have been concentrated in increased transfer payments and grants-in-aid.

In 1965, Federal purchases reached \$66½ billion, an increase of nearly \$1½ billion over the previous year. Measured on a year-to-year basis, non-defense purchases accounted for the entire increase and reflected a \$1 billion rise in outlays for the space program and small increases in other nondefense programs.

### Renewed advance in defense outlays

Although national defense outlays, which constitute the bulk of Federal purchases, showed no change on an annual basis from 1964 to 1965, there was a marked shift in the pattern of these purchases within the period, as chart 10 illustrates.

Defense expenditures declined appreciably in the latter half of 1964 and remained at this lower level in the opening half of last year. In the second half of 1965, defense spending was accelerated under the impetus of the increasing American commitment in Vietnam. Outlays for payrolls, ammunition, fuel, and supplies moved up rapidly. Military strength rose nearly 100,000 in the second half of the year. In addition, total military compensation was increased appreciably by a general pay raise for military personnel and by an extension of combat pay eligibility.

Expenditures for major hard goods categories—missiles, aircraft, and ships—did not show similar increases, because the Vietnam conflict has been fought mostly from stocks on hand. However, new orders for defense products have been advancing sharply in recent months.

### Social security benefits increase

Federal transfer payments increased over \$2 billion last year as compared

with a rise of about \$½ billion in the previous year. Enactment of the wide-ranging Social Security Amendments of 1965 in July increased benefit payments for 20 million persons by 7 percent. The higher payments were made retroactive to January, and a lump-sum disbursement was made in September, swelling transfers and personal income in the third quarter. By the fourth quarter, total transfers to persons were at an annual rate of nearly \$30½ billion.

Grants-in-aid to State and local governments advanced about \$1 billion in 1965. Most of this rise was in new or expanded programs associated with economic opportunity and education. Highway and public assistance programs, which had been major elements in the rise of recent years, showed little change.

Interest payments moved up with rising Treasury bill rates and some expansion in outstanding debt. Other Federal expenditures—subsidies and foreign transfers—were stable.

### Federal receipts up \$9½ billion

The sharpness of the advance in Federal receipts last year reflected the powerful revenue-generating capacity of the Federal tax structure under conditions approaching full employment. Federal revenues rose to \$124 billion, about \$9½ billion above the preceding year. This occurred despite the second stage of the 1964 cut in corporate income tax rates, which became effective at the opening of the year, and the cut in excise taxes in June.

Personal tax and nontax payments accounted for over \$5 billion of the total increase in revenues. Withheld taxes advanced sharply through 1965, in line with the large gains in wages and salaries. The second stage of the personal tax reduction lowered tax liabilities—from the 1964 schedule of 16-77 percent to 14-70 percent—but did not affect the statutory withholding rate, which remained at the 1964 level. As a result, tax payments approximated tax liabilities more closely in 1965 than in 1964 when substantial underwithholding was evident.

The 1964 underwithholding gave rise to unusually high net final settlements (on 1964 tax liabilities), which temporarily accelerated personal tax payments in the first half of 1965. This abnormal element tapered off in the latter half of the year, and nonwithheld taxes and refunds resumed a more normal pattern. The change of pace in personal tax payments from the first to the second half of the year contributed to the sharp turnabout in the overall fiscal position.

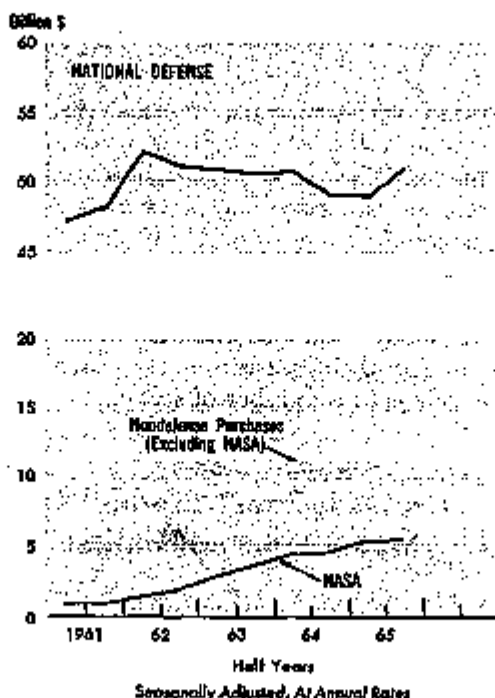
With corporate profits advancing by \$3½ billion, corporation income taxes rose about \$2 billion last year. The tax rise did not keep pace with the advance in profits because the surtax rate on corporate profits above \$25,000 was reduced from 50 percent to 48 percent.

### Cut in excise taxes

Last year's cut in excise taxes provided a good example of the ability of a rapidly expanding economy to offset rate reductions. Indirect business taxes rose more than \$½ billion above the 1964 level, notwithstanding a cut in

CHART 10  
**Federal Purchases of Goods and Services**

*Vietnam war reverses trend in defense purchases*



U.S. Department of Commerce, Office of Business Economics

65-139

excise taxes at midyear. These taxes, which had risen about \$½ billion in each of the previous 2 years, would probably have risen by well over \$1 billion last year if excise taxes had not been cut. In addition to the tax cut realized last year, the Excise Tax Reduction Act of 1965 called for reductions of \$1.7 billion in 1966. However, if Congress approves the recent Administration proposal to restore temporarily the levies on new cars and on telephone service to the pre-January 1, 1966, levels, the \$1.7 billion reduction originally indicated for 1966 will be lowered about \$1 billion.

The remaining major category of Federal receipts, contributions for social insurance, was up \$1½ billion as a result of higher earnings and employment. A much larger increase—over \$6 billion—is expected this year, primarily because of the 1965 Social Security Amendments. About \$5½ billion of this rise will result from the increase in the combined (employee-employer) tax rate from 7.25 to 8.4 percent and from the advance from \$4,800 to \$6,600 in maximum earnings subject to tax. Part of the tax rise is earmarked for the new hospital insurance program. In addition, starting July 1, social insurance contributions will be enlarged by payments from persons electing to participate in the supplemental medical insurance plan at a cost of \$3 per month.

#### *State and local outlays continue up-trend*

State and local governments continued to be a potent market force, generating \$68½ billion in purchases of goods and services last year, almost \$5½ billion more than in 1964. About two-thirds of last year's advance centered in employee compensation, mainly school payrolls. Public education employment rose by about 7 percent, and average pay also edged upward. Compensation in other areas continued to rise, reflecting the expanding level of government activity and higher average earnings.

Outlays by State and local governments for construction, which comprise more than one-quarter of total purchases, were up \$½ billion, somewhat

less than increases in earlier years. The advances, though relatively small, were widely distributed among most major types of construction, for example, schools, highways, and sewers.

#### *Further rise in State and local receipts*

Total receipts of State and local governments again exceeded expenditures, and amounted to more than \$74 billion, a rise of \$5½ billion over the preceding year. The surplus on income and product account came to \$1½ billion, about the same as in 1964. The large pension trust funds of these governments show substantial surpluses; if these funds were excluded from the consolidated accounts, a deficit position would be indicated for all other government activities. Most State and local governments rely on the relatively inflexible property tax for the major share of their receipts and operate under stringent borrowing restrictions—explicit voter approval is frequently required—and they are hard pressed to meet the demands stemming from rapidly growing community needs.

Indirect business taxes were responsible for about \$3½ billion of the rise in revenues, reflecting the brisk rate of economic activity as well as new and higher taxes. Many states adopted new sales taxes or raised previous rates. Increased State levies on cigarettes and gasoline were also evident. In addition, a growing number of local governments are collecting general sales taxes. The advance in these State and local taxes was especially marked in the second half of the year and served as a partial offset to the reductions in Federal taxes. Local property taxes, the principal revenue source of these governments, continued to push upward.

Personal taxes, which rose about \$1 billion, reflected the advance in income and increases in tax rates on earnings in a number of states.

### Gross National Product by Major Type of Product

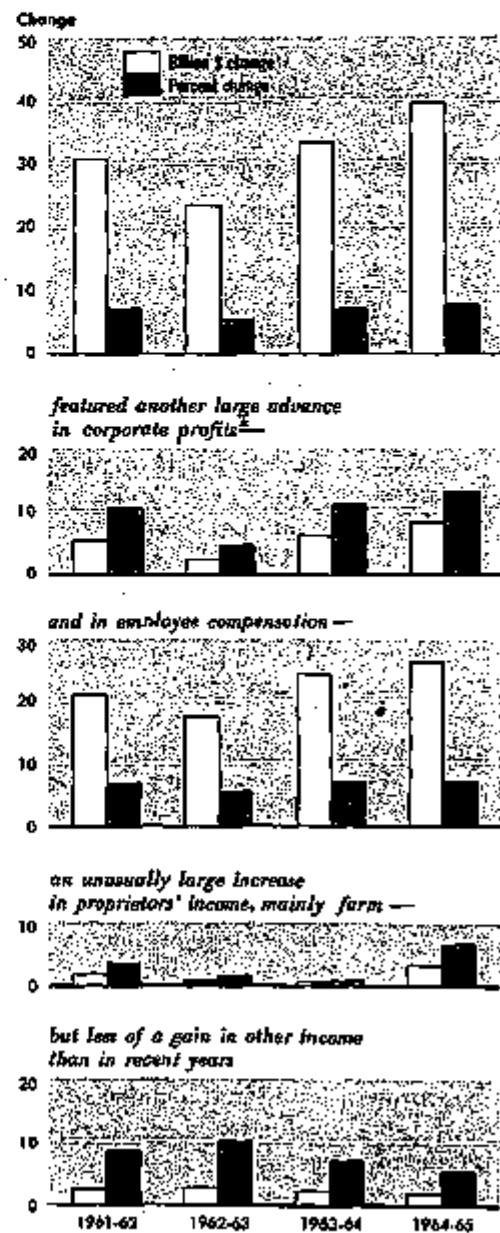
Last year's expansion in markets brought large increases in the production of all major types of products. In current dollars, production of durable

goods rose 10½ percent as compared with increases ranging from 6 to 7½ percent for other types of products—nondurable goods, services, and structures. The contrast was even more marked in terms of real output: 10½ percent for durables—the same as the current dollar rise—as against increases of approximately 4 percent for the others.

The 1965 rise in durable goods production reflected large increases in

CHART II

#### The 1965 Rise of \$40 Billion in National Income—



demand by consumers and business, but government purchases of hard goods were unchanged from a year earlier. The relative stability in the prices of durable goods in the face of heavy demand was due in part to the fact that the major share of last year's excise tax cut on durables was passed on in lower prices.

Increased business and government spending resulted in a 7½-percent rise in outlays for structures last year. In terms of physical volume, the gain was 4½ percent. In both current and constant dollars, last year's rate of gain exceeded that of the previous 2 years.

The 6-percent rise in the production of nondurable goods was the largest relative increase since 1951. However, the 1965 rise in prices of nondurables—2 percent—was twice as high as in other recent years, mainly because of

higher meat prices. In real terms, the 4-percent increase last year was little different from the previous year.

Increases in consumer expenditures for services and in government payrolls were reflected in a 7-percent rise in service output or 4½ percent in real terms. The 1965 gain in service output was moderately less than in 1964.

### National Income

The rise in durable goods production played a key role in last year's \$40 billion or 7½ percent increase in national income. From 1964 to 1965, income originating in durable goods manufacturing rose 11½ percent—and accounted for one-fourth of the rise in total income. Last year's advance in income originating in agriculture, which was due mainly to the spurt in farm prices, was also well above average.

The 1965 advance in production was also reflected in widespread increases among the various distributive shares. The sharpest gains were in corporate profits and farm proprietors' income. Employee compensation rose at a somewhat slower pace than the total (chart 11).

Advances in farm proprietors' income and corporate profits were most marked in the first half of the year. Beginning with the summer, the contribution of these income shares to the advance in total income tapered, and gains in employee compensation accounted for a greater share of the increase in the second half.

### Employee compensation up

Employee compensation rose \$26½ billion in 1965, of which private payrolls accounted for \$19½ billion, government payrolls \$4½ billion, and supplements to wages and salaries the remainder.

About half of the increase in private wages and salaries stemmed from the large increase in employment; the balance reflected chiefly higher rates of pay. Chart 12 illustrates components of payroll changes for production workers in manufacturing. For this group, higher employment accounted for more than half the rise in payrolls, and increased wage rates were responsible for

most of the remainder. Average weekly hours, at a postwar peak, were up only slightly on a relative basis.

Wages and salaries of government employees rose 7½ percent in 1965. The continuing rise in State and local payrolls reflected both higher employment and increased pay rates. Federal civilian employment did not rise last year, but average pay was increased late in the year. Military payrolls—which changed little in the first half—moved up in the second half because of a military pay raise, an extension of combat pay to all military personnel in Vietnam, and an increase in the number of men in the service. In the final quarter, military payrolls were 15 percent above their level a year earlier.

### Corporate profits rise sharply

Corporate profits before taxes (after adjustment for inventory gains) advanced 13½ percent last year to reach

CHART 12  
**Payrolls Rise Sharply**

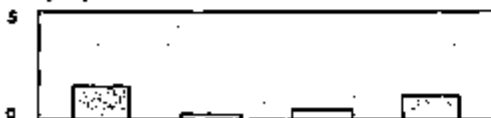
In 1965, payrolls for production workers in manufacturing increased 9 percent—



as the number of production workers rose almost 5 percent—



while their average weekly hours increased by 1 percent—

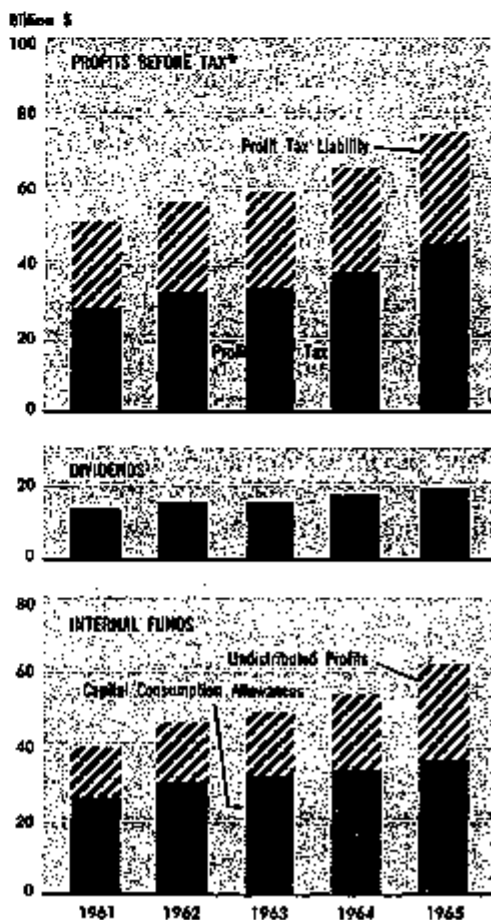


and their hourly earnings rose by slightly more than 3 percent



Data: BEA

CHART 13  
**Corporate Profits, Dividends, and Internal Funds at New Peaks in 1965**



\*Excluding WA

an annual total of \$73 billion. In both relative and absolute terms, this was the sharpest calendar-year rise since 1959. Four-fifths of last year's gain was scored in the first quarter and was heavily influenced by the spurt in automobile production. Profits continued to rise in subsequent quarters, but the rate of increase was not as great as the extraordinary first quarter rise.

Most industries shared in last year's advance in profits. The rise was especially marked in durable goods manufacturing, and in the transportation industries, where increases in volume had a considerable effect on earnings. Profits remitted from the rest of the world also rose rapidly last year, as companies stepped up the repatriation of earnings from abroad to conform to the Administration's voluntary program to improve the balance of payments.

After the initial recovery phase of the earlier postwar expansions, there was a tendency for profit margins to fall as the expansion progressed. In contrast, since the sharp rise in profit margins that accompanied the early recovery period of the current economic expansion, margins either have been stable or have risen slightly. Last year, corporate profits were 18 percent of corporate output, as compared with 17 percent in 1964. Margins rose sharply in the first quarter of last year and apparently changed little thereafter.

Profits after taxes rose 19½ percent last year to reach a total of about \$44½ billion. The sharper rise in after-tax profits than in before-tax profits stemmed from the second phase of the 1964 income tax cut. Corporate dividend payments did not match the rise in after-tax profits. At \$19 billion, dividends were only 9½ percent above a

year earlier. The combination of a marked increase in after-tax profits and a more moderate one in dividends was reflected in an unusually large gain—28 percent—in undistributed corporate profits. This rise, together with the long-term growth in corporate capital consumption allowances, helped boost internal funds 14½ percent.

#### *Farm income higher*

Last year featured a rise of about one-fifth in the income of farm operators (chart 14). This brought total farm proprietors' income to over \$14 billion—the highest level since 1952, when there were roughly 50 percent more farm operators than there are today.

The increase in farm income reflected principally an upsurge in prices received by farmers for meat animals. These prices moved up sharply in the second quarter, eased moderately thereafter, and then jumped sharply again in December. For the year as a whole, the rise in meat prices over 1964 was

almost 20 percent. The volume of farm output was up 4 percent from the previous year, and there was little increase in the unit operating expenses of farms.

### **Economic Expansion in 1965**

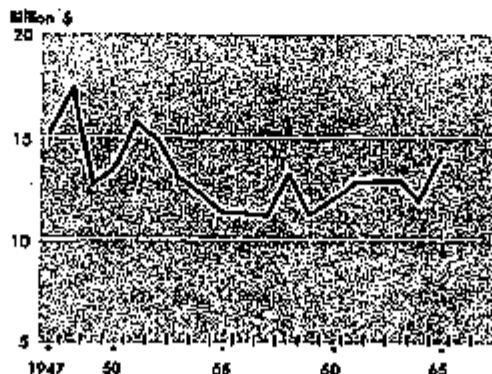
*(Continued from page 2)*

fict not in sight, by far the dominant factor, of course, was the prospective increase in defense purchases. Outlays by State and local governments could be expected to continue their strong upward trend.

As pressures on capacity mounted and the need for modernization continued, business was planning to make sizable increases in plant and equipment expenditures. It was not likely that residential construction would show much change in 1966; if anything, the tightening in interest rates was likely to dampen new starts by homebuilders. Business inventory demand was, as usual, an uncertain quantity. Because of longer delivery times and the possibility of shifts in price expectations, it was not clear that businessmen would continue the relatively conservative inventory policies generally pursued throughout the current expansion. A more rapid rate of increase in production abroad seemed likely, this would stimulate some growth in exports over late 1965 levels. Consumer income and spending could be expected to show further large gains in 1966.

In the above setting, continued increases in employment and decreases in unemployment could be anticipated. The main uncertainties regarding 1966 concerned the adequacy of supplies and stability of costs and prices.

**Farm Proprietors' Income in 1965 Was Higher Than in Any Year Since 1952**



U.S. Department of Commerce, Office of Business Economics

46-1-14

# The Production Expansion in Perspective

SINCE reaching a low point in the first quarter of 1961, real GNP has risen almost 30 percent over the past 19 quarters (chart 15). The increase in gross private domestic investment over the same period was almost double the overall rise, but if inventory investment is excluded from the comparison, the increase—in fixed investment—was close to 40 percent. This was still considerably more than the rise in the other three major markets—persons, government, and foreign. Within fixed investment, expenditures on producers' durable equipment increased far more than investment in structures.

The gain was somewhat less for personal consumption expenditures than for GNP, with purchases of durable goods expanding considerably more than the other two major groups of consumption expenditures. Total government purchases rose much less than average; the rise in State and local purchases was about 25 percent, double the Federal increase. Over this 19-quarter span, gross exports rose by more than one-third, imports rose still more, and net exports declined slightly.

## Sharp rise in durable goods

Changes in real output by type of product are shown in table 1. Since durable goods markets have expanded more rapidly than other markets in each year of the current expansion, the rise in the production of durable goods has outstripped by a wide margin the rise in the production of other types of products: nondurable goods, services, and structures. Indeed, last year durable goods output accounted for the largest share of total output for any year since World War II (table 2).

Apart from the shift in inventory investment—from a fairly sizable liquidation in early 1961 to a moderately large accumulation in late 1965—the rise in consumer and business invest-

ment markets has accounted for virtually all of the increase in durable goods production since the expansion started. The rise in consumer purchases has been widespread and has been particularly important in automobiles, furniture, and—during the last 2 years—color television. The fastest rising business purchases during this period were transportation equipment, office and computing machines, production machinery, and farm equipment.

Increases in auto production have played a key role in the rise of durable goods output since early 1961. Over this period, real auto product has grown about 120 percent and has risen from 3 to 5 percent of total output. Real auto product in 1965 rose 23½ percent over 1964, a much larger rate of increase than in 1963 and 1964 but slightly below the gain in 1962. Last year was the fifth straight year of generally rising auto production, making this the longest continuous increase in car output since the early postwar catching-up process boosted auto production for the years 1946-50.

Since early 1961, government purchases have on balance accounted for little of the rise in real durable output, partly because during these years Defense Department programs changed in emphasis.

## Industrial Effects of the Rise in Investment

Through the use of the total requirements table of the 1958 Input-Output Study, it has been possible to calculate the contribution of the rise in fixed

CHART 15  
**Advances in Real GNP  
in the Expansion Period**

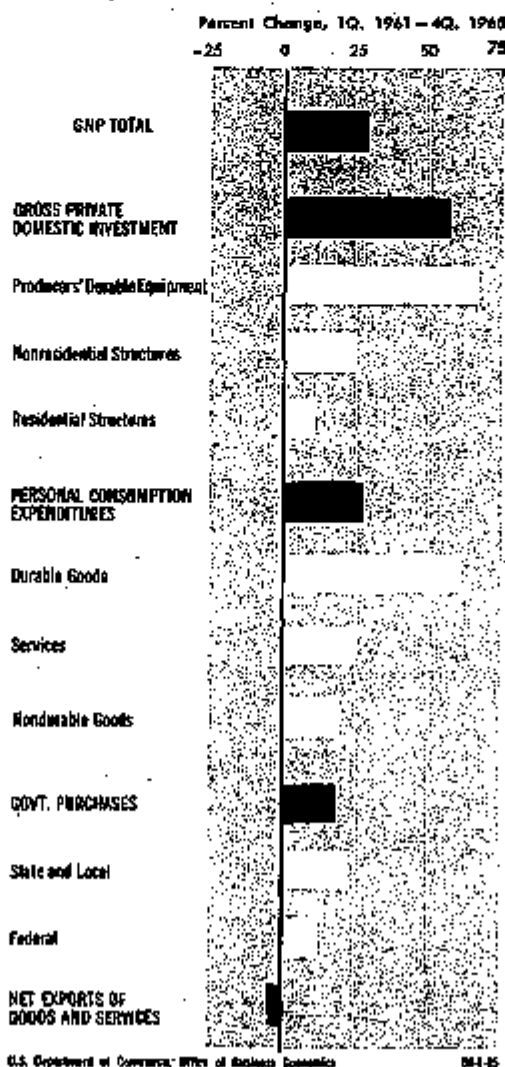


Table 1.—Percent Increases in Real Output, by Type of Product, First Quarter 1961–Fourth Quarter 1965

	Percent increase
Gross national product.....	29
Final sales.....	26
Goods output.....	31
Final sales.....	31
Durable goods output.....	50
Final sales.....	46
Non-durable goods output.....	22
Final sales.....	22
Services.....	24
Structures.....	16
Addendum: Auto product.....	117

Source: U.S. Department of Commerce, Office of Business Economics.

investment since 1961 to the (real) output increase in each of the industries in the economy. The results of these calculations are illustrated in chart 16.

In this chart, industries have been grouped into three categories: (1) those that increased more rapidly than real GNP from 1961 to 1965; (2) those that increased at roughly the same rate as real GNP; and (3) those that increased at a slower rate than real GNP. For each industry, the chart shows the proportion of its output increase that was due to the increase in fixed investment over the same period. In addition, the proportions are separated into the direct and indirect effects of the investment increase. Because of data limitations, the changes in chart 16 are based on annual figures for 1961 and 1965. Over this period, real GNP increased more than 22 percent, and fixed investment rose almost one-third, more than any other major market.

Table 2.—Percent Distribution of GNP by Type of Product in Current and Constant Dollars, Selected Years, 1948–65

	Based on current dollars					Based on constant (1958) dollars				
	GNP	Durable goods	Non-durable goods	Services	Structures	GNP	Durable goods	Non-durable goods	Services	Structures
1948.....	100.0	18.8	41.0	28.4	10.8	100.0	18.0	38.3	33.5	11.2
1953.....	100.0	21.8	34.2	22.6	11.4	100.0	23.0	32.6	34.0	11.4
1957.....	100.0	21.4	31.8	25.0	11.9	100.0	21.3	31.7	35.4	11.6
1958.....	100.0	19.7	32.9	26.5	11.9	100.0	18.7	32.9	36.5	11.9
1959.....	100.0	18.8	31.8	26.4	12.1	100.0	19.8	32.3	36.0	12.0
1960.....	100.0	18.7	31.3	27.2	11.3	100.0	20.0	32.5	36.2	11.3
1961.....	100.0	18.6	31.0	28.4	11.2	100.0	19.1	32.7	37.0	11.2
1962.....	100.0	19.6	31.3	29.1	11.2	100.0	20.2	32.2	36.5	11.1
1963.....	100.0	19.7	30.7	28.5	11.1	100.0	20.7	31.7	36.6	10.9
1964.....	100.0	20.1	30.2	28.8	10.9	100.0	21.3	31.4	36.6	10.6
1965 <sup>a</sup> .....	100.0	20.6	29.8	28.6	10.8	100.0	22.3	31.0	36.2	10.5

<sup>a</sup> Preliminary.

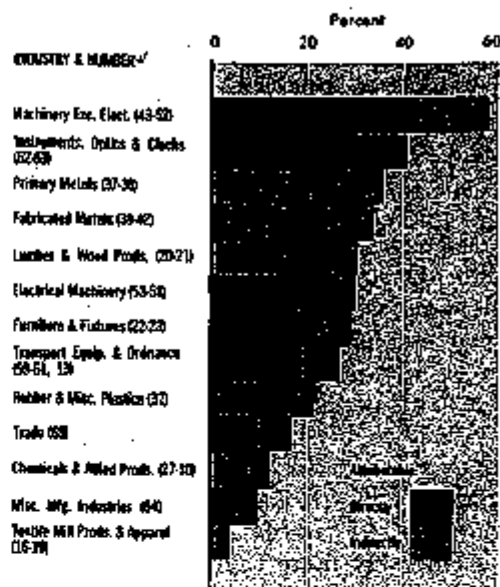
Source: U.S. Department of Commerce, Office of Business Economics.

In general, the industries whose relative expansion from 1961 to 1965 exceeded the rise in GNP were more dependent on the increase in fixed investment than were the industries whose output increased at average or less-than-average rates. Moreover, for the top group of industries it made no difference whether this dependence was direct or indirect. For example, the investment expansion directly caused a sharp rise in the output of equipment producers and indirectly brought about a substantial increase in the output of those industries supplying equipment producers. More than one-third of the output increase in primary metals was dependent on the pickup in investment demand, and almost all of it was indirect. It is also apparent that the fixed investment increase accounted for significant proportions of the output rise of industries that have little close relationship to fixed investment. A good example is chemicals, 10 percent of whose production increase was indirectly due to the fixed investment advance.

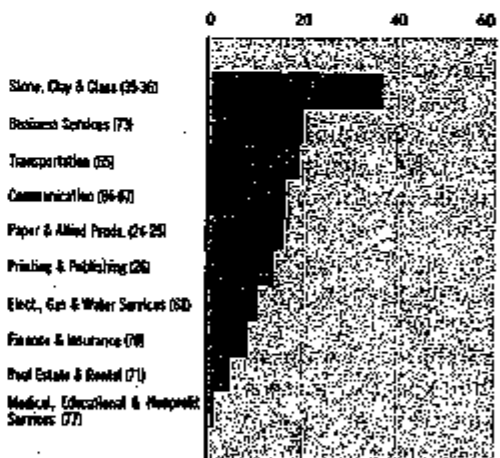
Not all of the industries with above-average rates of output increase were especially dependent on the expansion in investment, nor did every industry especially dependent on investment show a better-than-average increase in output. Because the explanations are fairly lengthy, no attempt is made here to explain, on the one hand, the greater-than-average expansion in the production of chemicals, trade, and textiles and, on the other hand, the average rate of expansion in stone, clay, and glass.

CHART 16  
Proportion of Each Industry's Output Increase Attributable to Increases in Private Domestic Fixed Investment, 1961-65

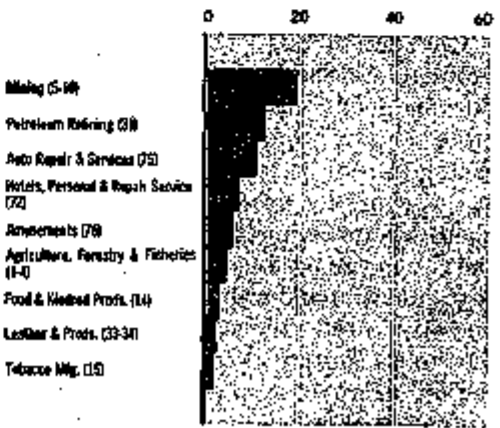
Industries with above average increases in output



Industries with about average increases in output



Industries with below average increases in output



<sup>a</sup> Input-output code number. See Sept. 1965 Survey for definitions.



## Postwar Growth Rates

Chart 17 illustrates annual average rates of growth in real output for the postwar period (1948-65) and for peak-to-peak years of the successive postwar business cycles. Growth rates are shown first for total GNP and then for major markets and types of products. In all cases, the rates (compounded) are based on the change from the beginning to the ending year.

Real GNP has increased at an average annual rate of 4½ percent in the 5 years since 1960, the peak of the incomplete economic recovery that started in 1958. This is well in excess of the average rate of 3½ percent for the entire period from 1948 to 1965. The rate was highest (5 percent) in the years that included the Korean war but showed a considerable retardation from 1953 to 1957 and from 1957 to 1960.

The fastest growing markets in the 1960-65 period have been consumer durables and private investment. Consumer durables increased at an average rate of 7½ percent and private investment by 5½ percent; for both, average rates of increase were well above those of prior periods. The high rate for consumer durables since 1960 has reflected in large measure the unusual growth in automobile demand, and the increase in private investment has been due primarily to exceptionally large gains in producers' durable equipment.

The growth since 1960 in consumer spending on nondurable goods and services combined, almost 4 percent, has been somewhat smaller than the growth of real GNP but larger than the averages of the earlier periods. Consumer purchases of nondurable goods and of services were both up as compared with earlier periods, but the rise in nondurables was more marked.

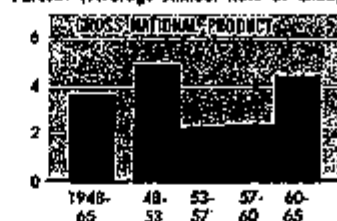
The two government sectors show diverse patterns. Since 1960, Federal Government purchases have increased at an average annual rate of 2½ percent, about half the rate for total GNP, while State and local purchases have increased at a 5-percent rate.

(Continued on page 26)

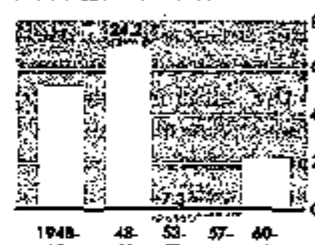
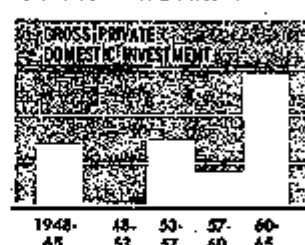
## Since 1960 the Growth Rate of Real GNP Has Exceeded the Postwar Average and Has Been Much Higher Than in the Period 1953-60

CHART 17

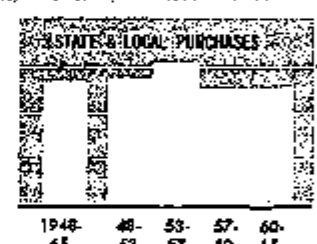
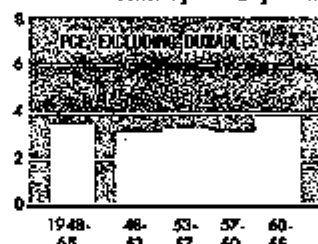
Percent (Average Annual Rate of Change)



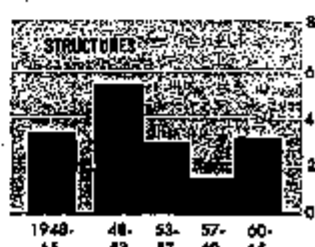
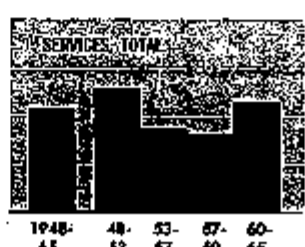
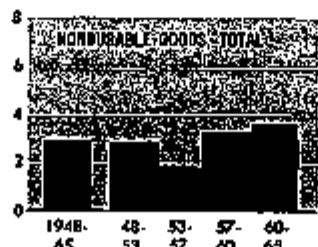
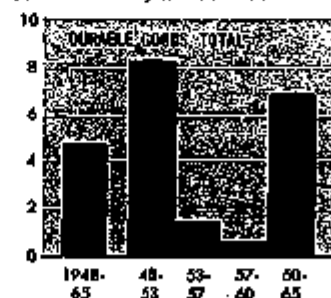
As Compared With 1953-60, Changes in Growth Rates in the Post 5 Years Have Been Pronounced in Durable Consumption Expenditures, Gross Private Domestic Investment, and Federal Purchases —



and Smaller in Other Consumption Expenditures, and State and Local Government Purchases



These Market Shifts From 1953-60 to 1960-65 Have Affected Mainly the Growth Rate of Durable Goods Production



# The Balance of Payments

THE year 1965 opened with the balance of payments and U.S. reserves under severe strain. Both exports and imports were low because of the strike in the shipping industry, but since exports were more severely affected, the trade balance was sharply depressed. Capital outflows, which had risen substantially in 1964, continued to expand, particularly through increased bank loans and direct investments; the rise may have occurred partly in anticipation of later restrictions. Gold outflows were among the highest on record. They reflected an extraordinary demand for gold not only from foreign official agencies but also from foreign private sources. This demand was stimulated

by the large dollar outflow in previous periods. The adverse balance of payments of the United Kingdom and the resulting decline of confidence in sterling during the latter part of 1964, which originated largely with nonofficial sterling holders, may also have contributed to the widespread rise in the demand for gold.

These developments formed the background for the actions taken by the President last February in which he confirmed the intent of the Government to maintain the current exchange value of the dollar, and announced a program to achieve that goal. The program consisted mainly of an appeal to banks to restrict their lending to foreign customers in 1965 to an increase of 5 percent over the amounts outstanding at the end of 1964, and also to non-financial corporations to improve the balance on their foreign transactions and to repatriate liquid funds held abroad to the maximum extent. It also extended the Interest Equalization Tax to loans by banks and other financial organizations. The program included an intensification of previous efforts to reduce Government expenditures abroad, to increase exports, and to attract foreign travelers to the United States.

Certain parts of the program to improve the balance of payments were immediately effective. Bank loans started to decline in March, and substantial amounts of short-term funds were repatriated by nonbanking corporations before the end of the first quarter. Moreover, the trade surplus improved with the ending of the dockworkers' strike in the major ports in

mid-February and in other ports early in March. For the first quarter as a whole, the decline in reserve assets and the increase in liquid liabilities to all foreigners totaled roughly \$700 million—after seasonal adjustment—considerably less than in the last quarter of 1964 and during the first 2 months of 1965. Excluding liquid liabilities to foreign private accounts, the adverse balance was slightly lower.

Repatriations of banking claims, further withdrawals by nonbanking corporations of funds held in foreign banks, and the speedup in strike-delayed export shipments resulted in still more improvement of the balance during the second quarter. However, the effects of the balance of payments program and the settlement of the shipping strike were partly offset by sluggishness in business activity in some of

Table 1.—U.S. Balance-of-Payments Transactions, 1963, 1964, and January-September 1965 at Annual Rate

	1963	1964	Jan.-Sept. 1965 (seasonally adjusted annual rate)
U.S. payments (recorded), excluding reserve assets:			
Imports of goods	16.99	15.62	22.37
Imports of services	9.45	8.84	10.37
Private remittances and Government transfers	.83	.84	1.09
Government grants and net capital flows	3.38	2.86	2.23
Increase in U.S. private assets abroad, net	4.46	4.46	3.64
U.S. receipts (recorded), excluding liquid liabilities:			
Exports of goods	22.07	23.29	23.53
Income on investments	4.65	5.46	6.30
Exports of services	5.03	6.77	6.55
Increase in foreign assets in the United States, net	.77	.08	.04
Change in U.S. official reserve assets, net (decrease -)	-1.36	-1.17	-1.27
Change in liquid liabilities (increase +)			
Foreign official agencies	-1.60	-1.05	+1.03
Other foreign accounts	-.53	-1.55	-1.03
Errors and omissions (net payments -)	-4.46	-1.16	-4.49

Table 2.—U.S. Private Assets Abroad: Suggested Ceilings Outlined in 1966 Balance of Payments Program

	(Billions of dollars)
Net capital outflows for direct investments and reinvested earnings in developed countries:	
1962-64 total	7.92
Direct investment outflow	4.89
Reinvested earnings	3.03
1965-66 ceiling (90 percent of 1962-64 total)	7.13
Claims on foreigners reported by U.S. banks:	
Amount outstanding December 31, 1964	9.49
September 30, 1965	8.48
December 31, 1966 ceiling	10.44
Foreign assets of nonbank financial institutions:	
Amount outstanding December 31, 1964	3.33
September 30, 1965	3.15
December 31, 1966 ceiling	3.25
Short-term foreign assets of U.S. corporations:	
Amount outstanding December 31, 1964	.45
September 30, 1965	.36
December 31, 1966 ceiling	.43

\*Ceiling on assets over 10 years maturity applies only to assets in developed countries other than Canada and Japan. These amounted to \$1.63 billion at the end of September 1965. The December 31, 1966, ceiling is \$1.72 billion.

the major countries abroad, which had an adverse effect on U.S. exports, and by the sharp rise in U.S. imports, which was related partly to protective buying in anticipation of a strike in the steel industry. Nevertheless, the drop in

reserve assets was reduced in the second quarter to less than one-tenth of what it had been in the first quarter, and liquid liabilities, mostly to foreign official organizations, declined by an even larger amount. However, that change to a favorable balance, the first since 1957, was not expected to continue since it was based to some extent on repatriations that were not likely to be sustained and on a temporary upsurge in exports.

During the second half of the year, the balance turned adverse again since repatriations did not continue. However, limitations on new bank loans, a decline in capital outflows through direct investments to not much more than 50 percent of the rate in the first half of the year, and a moderate rise in the trade balance kept the deficit much below the average rate for the years 1958 to 1964. It was not quite \$500 million in the third quarter and somewhat less in the fourth. The balance based on changes in reserve assets and in liabilities to foreign official organizations during the second half of 1965 was also adverse.

For 1965 as a whole, the adverse balance composed of declines in U.S. official reserve assets and increases in all liquid liabilities was less than half of the \$2.8 billion deficit in 1964. The alternative balance composed of changes in U.S. reserve assets and in liabilities to foreign official organizations only, which had improved substantially from 1962 to 1964, probably was little changed in 1965.

The total 1965 improvement was divided in roughly equal parts between a reduction in U.S. international payments and an increase in receipts. On the payments side, the sharp cutback in private capital outflows was offset to some extent by the rise in U.S. merchandise imports. In the receipts account, increased merchandise exports and income on investment bolstered the total (chart 18).

Balance of payments developments in 1965 indicated that further improvements in the balance were still required and that the program to achieve them had to continue. Accordingly, on December 6, it was announced that the program would be extended into 1966.

The features of the original program were retained, and new ceilings for U.S. private assets abroad in 1966 were outlined. These ceilings for the various categories of private capital are listed in table 2.

## Economic Developments Abroad

U.S. international transactions were affected by economic developments in the United States, reviewed elsewhere in this issue, and by trends abroad, which are discussed briefly here.

In 1965, the rate of economic growth in most industrial areas abroad slowed down considerably. This was reflected in the movement of U.S. exports and may also have contributed to the decline in U.S. private capital outflows during the year (chart 19). The slower rise in foreign demand may also have contributed to the increase in U.S. imports by stimulating foreign businessmen with idle productive capacity to expand their sales in the United States.

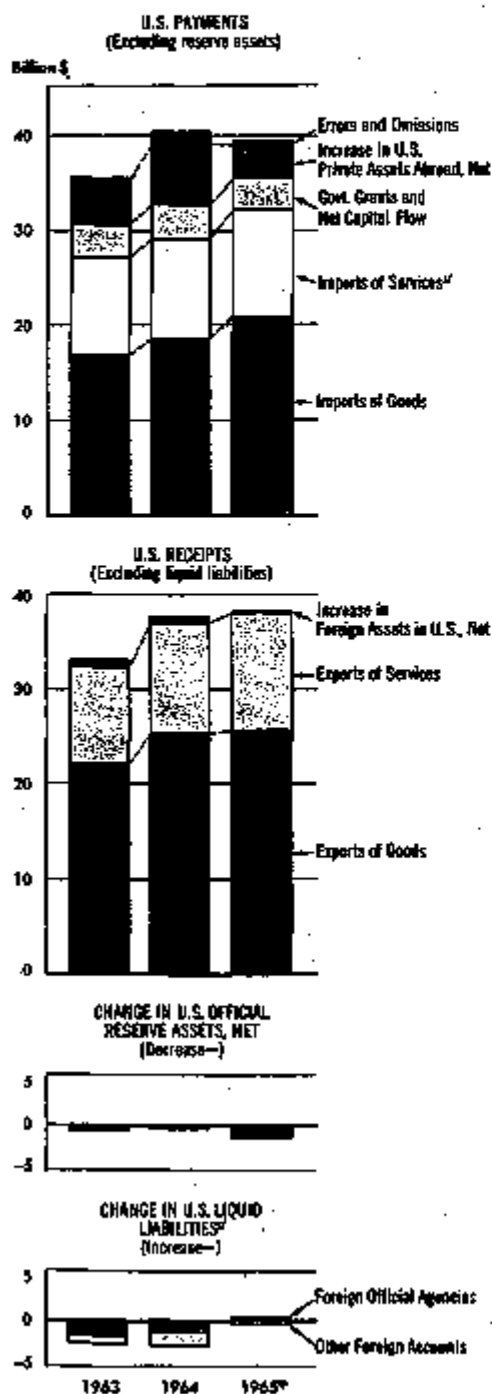
In Western Europe, the rate of economic growth slackened in 1965 for the second consecutive year. Industrial production rose only about 2 percent from the fourth quarter of 1964 to the third quarter of last year. In France and the United Kingdom, industrial production showed little or no gain over that period. There was a moderate advance in Germany, and in Italy there was a recovery from reduced levels of production in 1964. Industrial production in Japan, after expanding vigorously for several years, remained almost stationary during 1965.

The slower advance in demand in these areas was reflected in our sales. Exports to Europe, our fastest growing market for the past several years, rose by only 2 to 3 percent in 1965, and shipments to Japan also expanded very little.

In Canada, industrial activity continued to increase last year, keeping pace with the expanding U.S. economy. Canada was the most buoyant market for U.S. exports in 1965; shipments there expanded by approximately 10 percent.

CHART 18

### International Transactions of the United States



\*Includes net private remittances and unilateral transfers.

\*Including certain non-U.S. Government obligations.

\*U.S. payments and receipts are based on Jan.-Sept. data at annual rate; other data are estimated annual totals.

U.S. Department of Commerce, Office of Business Economics

66-1-18

Demand in the expanding economies of Australia and South Africa also continued to increase in 1965, and even though reduced foreign trade earnings caused a drop in their reserve holdings, U.S. shipments to those countries advanced for the second straight year.

Modest increases in foreign exchange earnings of the less developed countries (other than those producing oil) were used to finance larger expenditures abroad in 1965. These were reflected in U.S. exports to these countries, which rose slightly in 1965.

The current outlook for 1966 is for the Canadian economy to continue to boom and for rates of growth in some Western European countries and in Japan to improve moderately. Foreign exchange earnings of the less developed countries may rise through increased sales to the industrial areas. With U.S. demand also rising rapidly and with productive resources in the United States more fully employed, an acceleration in foreign business activity may not affect U.S. exports, particularly capital goods, as much as it did in the past.

### Special developments in the United Kingdom

The uncertainty of the balance of payments position of the United Kingdom which followed the serious sterling crisis of November 1964 and persisted through the early fall of 1965 had a major impact on U.S. international transactions. The conversions in the spring and summer months of U.S. corporate securities held by British authorities and the deferral for the second straight year of the annual payment of principal and interest due the United States on the postwar loan to the United Kingdom affected our payments position adversely. In addition, during the summer months, the Federal Reserve Bank of New York extended substantial assistance on a swap basis, increasing holdings of sterling in exchange for dollars. Beginning in September, the British position improved considerably when a 10-nation standby credit was accorded the United Kingdom and confidence in the pound was restored. These developments resulted in large shifts of foreign-held liquid

dollar assets from foreign official to private accounts during the third quarter and back to foreign official accounts in the fourth quarter of last year.

### Merchandise Trade

The merchandise export surplus narrowed from \$6.7 billion in 1964 to about \$5.0 billion in 1965. U.S. exports of merchandise, after a 15-percent rise in 1964, rose about 4 percent in 1965. Imports, in contrast, increased about 15 percent in 1965 after a 10-percent gain in the preceding year.

In addition to the slower rise in foreign demand in 1965, exports may

have been affected by reduced capital outflows. Some of the loss of exports caused by the dockworkers' strike early in the year may have been irretrievable. Also, as demand pressed against plant and labor capacity in this country, lengthened delivery times and less aggressiveness by U.S. firms selling in foreign markets may have weakened our competitive position.

U.S. exports in the first half of 1965 dipped below the level in the preceding half year partly because of reduced agricultural shipments and partly because some goods had been preshipped in late 1964 to avoid delay from the longshoremen's strike. In the second half of the year, both agricultural and nonagricultural shipments increased, and total exports rose to a new record.

For the year as a whole, agricultural exports were about equal to those in 1964. Exports of feed grains and vegetable oils continued to expand in 1965 and offset declines in cotton and wheat. Wheat exports picked up after midyear when the U.S. price fell and European demand rose. Most of the advance in nonagricultural exports was in capital and automotive equipment. Other increases in exports included nonferrous metals, reflecting both volume and price gains.

In both 1964 and 1965, the accelerated advances in domestic production and income resulted in substantial increases in imports. Industrial supplies and materials accounted for a large part of the gain in U.S. imports last year. Some of this rise was in steel products, for which large foreign orders were placed as a hedge against the threatened steel strike in the United States.

Imports of capital equipment and consumer goods also increased considerably in 1965. Only imports of foodstuffs showed little change from 1964. This was partly because of reduced prices for imported foodstuffs and partly because for some foodstuffs domestic inventories were drawn down in lieu of a larger volume of imports.

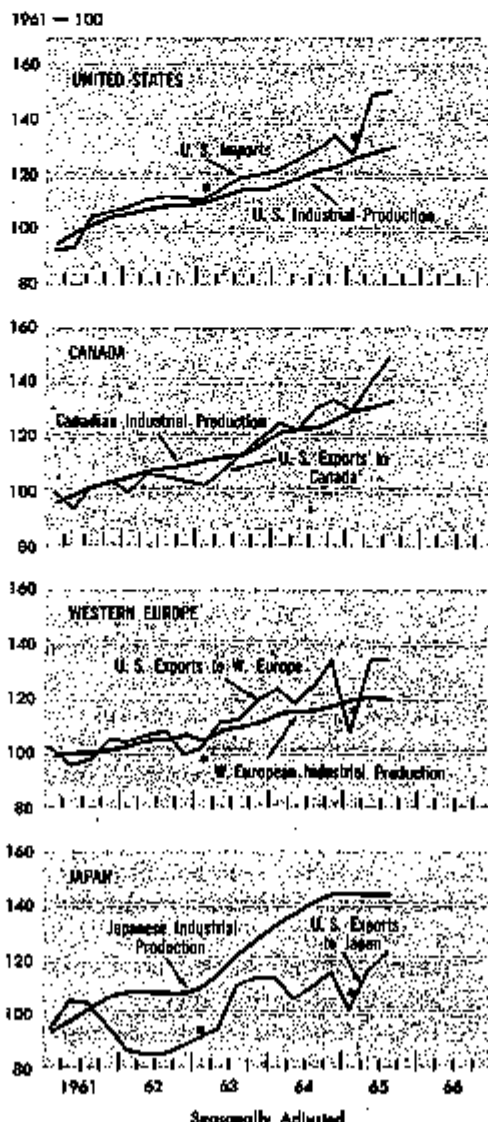
### Government Transactions

U.S. military expenditures, after declining during 1964 and the first quarter

(Continued on page 25)

CHART 19

### Industrial Production and Related U. S. Foreign Trade in Major Industrial Areas



\*Major U. S. strikes in shipping industry

U.S. Department of Commerce, Office of Business Economics

65-13

# Employment—Prices—Finance

**T**HE strong expansion of the economy in 1965 was accompanied by an unusually large advance in employment. Although the rise in the labor force was above the average of recent years, the expansion in jobs was greater and unemployment was significantly reduced. On an annual basis, the unemployment rate averaged 4.8 percent last year, as compared with 5.2 percent in 1964 and 5.7 percent in 1963. At the start of 1965, the unemployment rate was 5 percent, but the steady improvement through the year brought the rate by yearend close to the Administration's interim goal of 4 percent.

Toward the end of the year, the labor market presented a mixed picture. Unemployment rates for young people were still far above average; despite improvements, rates among Negroes were nearly double the average; rates for white adults were quite low. In certain occupations and industries in particular geographic areas, labor shortages were prevalent.

## Labor force expands

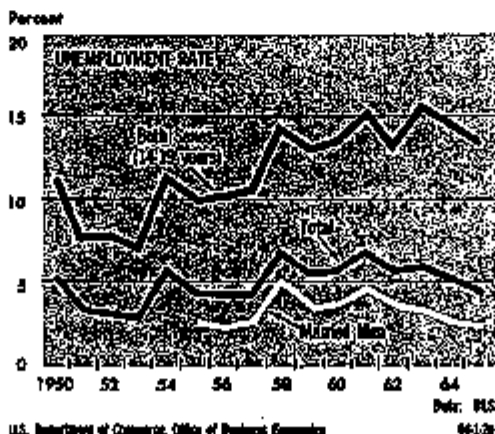
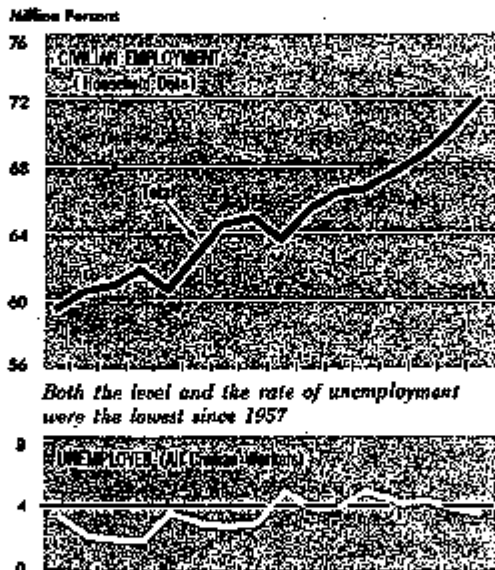
The civilian labor force averaged 75.6 million in 1965, a rise of 1.4 million from 1964. The growth in the labor force was slightly larger than the year before, and considerably larger than in the earlier years of the 1960's. The largest relative expansion in 1965 was in the teenage group, which rose by more than 500,000 for the year as a whole and by 1 million within the year. These large increases were mainly a reflection of the bulge in the birth rate in the very early postwar period. The number of adult women in the labor

force continued to grow, with a rise of 600,000, but the number of adult men rose only 200,000.

CHART 20

## Labor Market Developments

The 1.8 million rise in employment last year exceeded the large increase in 1964



Total civilian employment, at 72.2 million (household basis), increased 1.8 million from 1964 to 1965. Adult women accounted for a little more than 700,000 of the increase and adult men and teenagers for roughly 500,000 each. For adults of each sex, the employment increase exceeded the rise in the labor force; for teenagers, the advances were about equal.

## Increases widespread by industry

Except for employment in agriculture and mining, where longrun declines were extended, employment in 1965 showed a broad industrial advance that was sustained throughout the year and accelerated in the fourth quarter. In nonagricultural establishments, the gain over 1964 was more than 2 million jobs, and in manufacturing alone, almost  $\frac{1}{2}$  million. About half of the overall rise was in private nonmanufacturing, with all major groups except mining contributing to the advance. In nonmanufacturing, relative gains were large in trade and finance, where employment has been showing a strong secular increase, and in contract construction, which rose mainly because of the large advance in private nonresidential construction last year. State and local government employment was up 400,000, extending the strong upward trend of the past several years, but Federal employment was little changed.

Last year's large increase brought factory employment to an alltime high of 18 million, which exceeded the postwar peak of 1953 as well as the alltime peak reached during World War II. In the durable goods industries, where the 1965 expansion in employment centered, a tight labor market developed

toward the end of the year, with shortages appearing in several types of skills. Employment increases in 1965 were quite general throughout the durable goods group. Transportation equipment and electrical equipment led the advance, and machinery and fabricated metal products also made good gains. In the nondurable goods industries, small employment increases occurred in all except the food, tobacco, and petroleum refining industries.

### Rise in blue collar employment

Both white and blue collar employment rose considerably last year. For the former, it was an extension of a longrun trend, but for the latter, it was a development of fairly recent origin, as chart 21 shows.

The absence of long-term growth in manufacturing employment for several years after 1953 was a factor in the lack of growth of blue collar employment. Since the current economic expansion started in early 1961, however, such employment has been moving higher. It is only in the last 2 years,

however, when manufacturing increased considerably, that blue collar employment showed a sharp expansion. More blue collar workers were employed in 1965 than at any other time in the postwar period.

### Longer hours

The expansion in labor requirements last year was met largely by increased employment, but hours of work were also lengthened, both by increased overtime work and by the substitution of full-time work for part-time schedules. In nonagricultural industries, the number of persons working over 40 hours per week increased by nearly 1½ million from 1964 to 1965; a similar increase occurred in those working from 35 to 40 hours. A decline of over 1 million took place in those working less than 35 hours.

The average workweek for production workers in manufacturing exceeded 41 hours in 1965 for the first time (annual basis) since World War II. The rise for the full year was 0.4 hours. Increases in hours worked per week were general by industry and were larger than average in durable goods, where overtime work was especially heavy.

### General reduction in unemployment

Fewer persons were out of work in 1965 than in any other year since 1957. The average number of unemployed was 3.4 million, a reduction of 400,000 from 1964 and a substantial improvement from the second quarter of 1961, when unemployment, at 5 million, was at its recent peak.

The reduction in both the level and rate of unemployment in 1965 was quite general, except for teenagers, and during the year extended throughout the various categories of occupation, sex, color, marital status, and length of time unemployed (table 1). Adult male unemployment, which dropped just below 4 percent in 1964, declined to 3.2 percent in 1965; for adult females, the rate declined from 5.2 percent to 4.5 percent. For the most experienced group in the labor market, married men, the unemployment rate in December was 1.8 percent, the lowest since 1953.

The level of teenage unemployment was unchanged, and the rate, though

a little lower than 1964, continued high at 13.6 percent. The outstanding developments in the teenage labor market last year were the unusually large rise in the teenage labor force and the success young people had in finding jobs. The rise in employment reflected both the buoyant demand for labor and special efforts to employ teenagers—the President's summer employment program and the programs associated with the attack on poverty.

Table 1.—Selected Aspects of Unemployment

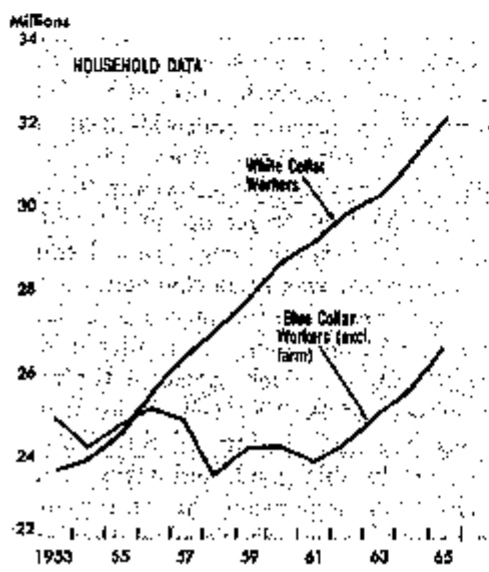
	[Percent]							
	1953	1959	1960	1961	1962	1963	1964	1965
<b>Unemployment rates:</b>								
Total.....	3.3	5.5	5.6	5.7	4.8	4.7	5.2	4.5
Male.....	3.5	5.3	5.4	5.5	4.2	5.3	4.7	4.0
14 to 19 years of age.....	9.6	13.2	14.0	13.4	13.3	15.5	14.3	13.1
20 and over.....	2.4	4.7	4.7	5.7	4.6	4.5	3.9	3.2
White.....	3.1	4.6	4.8	5.7	4.6	4.7	4.2	3.6
Nonwhite.....	7.3	11.3	10.7	12.9	11.0	10.6	9.1	7.8
Married, with spouse.....	2.3	3.6	3.7	4.6	3.6	3.4	2.8	2.4
Single.....	7.7	11.6	11.7	13.1	11.2	12.4	11.5	10.1
Female.....	4.3	5.9	5.9	7.2	6.2	5.6	6.3	5.5
14 to 19 years of age.....	9.9	12.3	12.9	14.9	13.2	16.7	15.0	14.3
20 and over.....	4.2	5.2	5.1	6.3	5.4	5.4	5.3	4.5
White.....	3.8	5.3	5.3	6.5	5.3	5.8	5.5	5.0
Nonwhite.....	8.0	9.5	9.5	11.9	11.1	11.3	10.8	9.3
Married, with spouse.....	2.6	5.2	5.2	6.4	5.4	5.4	5.1	4.5
Single.....	5.8	7.1	7.5	8.7	7.9	8.9	8.7	8.2
<b>By Occupations:</b>								
White-collar workers.....	1.7	2.6	2.6	3.3	2.8	2.8	2.8	2.3
Professional and technical.....	1.0	1.7	1.7	2.0	1.7	1.5	1.7	1.5
Managers, officials, and proprietors.....	.8	1.3	1.4	1.8	1.5	1.5	1.4	1.1
Clerical workers.....	2.4	3.7	3.8	4.6	3.9	4.0	3.7	3.2
Sales workers.....	2.7	3.7	3.7	4.7	4.1	4.2	3.9	3.3
Blue-collar workers.....	5.1	7.6	7.8	9.2	7.4	7.2	6.3	5.3
Craftsmen and foremen.....	3.2	5.3	5.3	6.3	5.1	4.8	4.2	3.8
Operatives.....	5.4	7.6	8.0	9.6	7.5	7.4	6.5	5.6
Nonfarm laborers.....	5.2	12.4	12.5	14.5	12.4	12.1	10.6	8.4
Service workers.....	4.6	6.0	6.7	7.0	6.0	6.0	5.8	5.2
Private household workers.....	4.2	4.8	4.9	5.9	4.9	5.2	4.9	4.2
Other service workers.....	4.8	6.4	6.0	7.4	6.4	6.2	6.1	5.5
Farmworkers.....	1.9	2.5	2.7	3.0	2.3	2.0	3.1	2.0
Farmers and farm managers.....	.4	.3	.3	.4	.3	.5	.5	.4
Farm laborers and foremen.....	3.7	5.1	5.3	5.7	4.3	5.0	5.8	4.6
<b>Percent distribution of unemployed by duration of unemployment:</b>								
Less than 5 weeks.....	52.4	43.5	45.7	50.5	46.8	44.2	45.1	49.7
5-14.....	25.4	29.2	29.9	28.6	28.3	29.5	25.8	23.5
15-26.....	10.7	12.8	12.8	15.1	13.3	12.6	12.6	11.7
27 weeks and over.....	8.2	15.0	11.6	16.7	15.6	13.5	12.4	10.2

Sources: U.S. Department of Labor, Bureau of Labor Statistics.

### Employment Trends, by Occupation

• Employment of blue collar workers has risen to new highs in the past 2 years

• The uptrend in employment of white collar workers has been extended



Data: BLS

66121



## Price Developments

In 1965, prices continued the moderate uptrend that has been evident in recent years, although increases were somewhat larger than in any other year of the business expansion. The largest rises occurred in the second quarter and in the closing months. The spring increase was primarily in farm products at all market levels; the advance late in the year was somewhat more general.

The most important price developments in 1965 were the large increase in farm prices and the modest advance in wholesale industrial prices after several years of little change. The table be-

low shows annual percentage changes for major price measures:

	1964-65	1963-64	1962-63	1961-62
Consumer price index.....	1.2	1.3	1.3	1.6
Wholesale price index.....	.3	-.3	.2	2.0
Industrial commodities.....	0	-.1	.5	1.3
Prices received by farmers.....	1.7	-.8	-2.5	6.1

### Wholesale industrial prices rise

Last year, wholesale prices of commodities other than farm products and processed foods, which had remained virtually unchanged from mid-1959 to late 1964, moved moderately but distinctly higher. On an overall basis, prices rose each quarter, and for the entire year, they averaged 1.3 percent above the 1964 level.

Several factors contributed to the increase in industrial prices in 1965. With capacity utilization in manufacturing for the year as a whole higher than at any other time during the current expansion and close to the very high rates of 1955, rising demand was reflected in price boosts in a number of industries. Higher unit costs also contributed to price increases. In some industries, shortages of qualified workers, chiefly late in the year, were responsible for rising unit labor costs; in others, the utilization of marginal plant facilities pushed up production costs. In the closing months of the year, the escalating military conflict in Vietnam may have given rise to speculative price increases.

Federal Government policies had a direct influence on prices last year. After the announcements of price increases for copper and aluminum in the fall, the Government intervened actively under the wage-price guideposts to bring about revocation of the increases. The existence of the guideposts undoubtedly served as a deterrent to other price advances. In addition, most of last year's cuts in excise taxes were passed on in the form of lower prices, particularly for motor vehicles and several consumer appliances.

Among the 13 major commodity groups of the BLS index, metals, fuels, hides, and miscellaneous products registered price increases for the full year that exceeded the average rise; 8 other

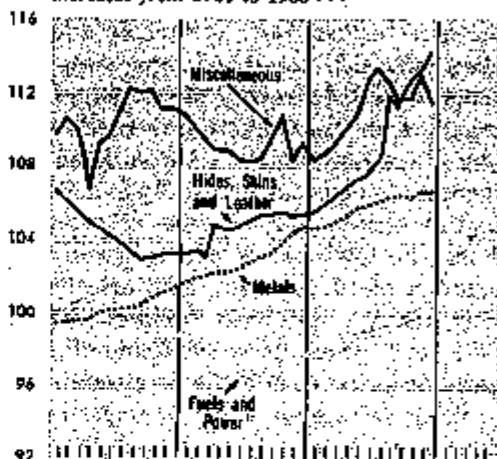
CHART 23

## Wholesale Prices — Industrial Commodity Groups

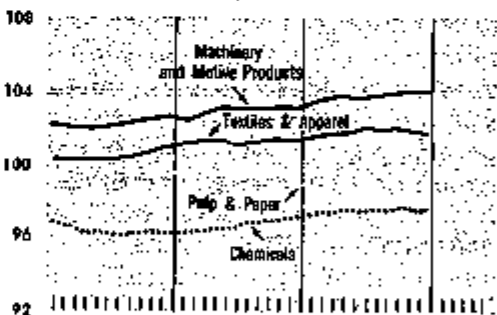
1957-59 = 100



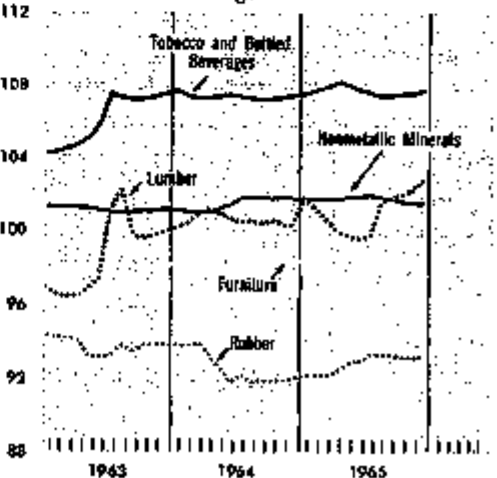
These groups showed above average increases from 1964 to 1965...



These showed small rises...



and these little change



Seasonally Adjusted

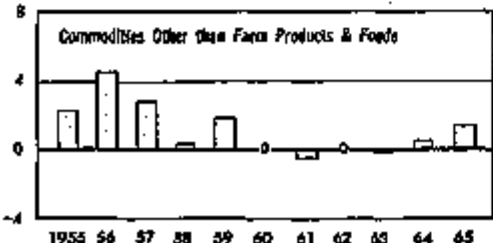
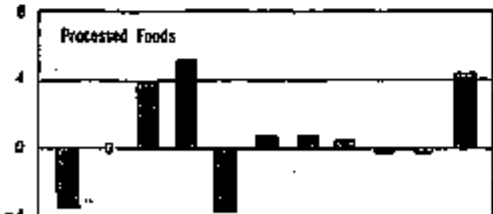
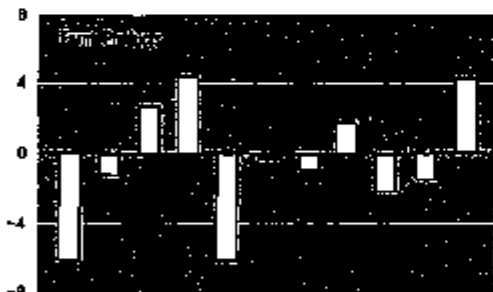
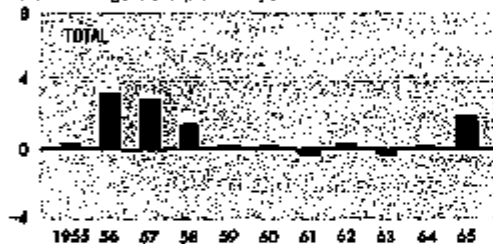
Data: BLS, with seasonal adjustment by OBE  
65-1-22

U.S. Department of Commerce, Office of Business Economics

CHART 22

## Wholesale Price Index

Percent change from previous year



Data: BLS  
65-1-22

U.S. Department of Commerce, Office of Business Economics

categories were up less than 1 percent, and 1—furniture and appliances—declined (chart 23). On a weighted basis, about two-fifths of the 1.3 percent rise in industrial commodity prices was due to higher prices for metals and metal products, and of this increase, 70 percent was attributable to nonferrous metals. Fuel and machinery prices each accounted for about one-sixth of the overall industrial price increase.

The price increase in hides, skins, and leather—which was the largest among the major commodity groups—was associated with a restriction of supplies, arising from the reduction in cattle and hog slaughter, and with a substantial increase in demand, especially from shoe manufacturers. Fuel prices rebounded from the low level reached late in the summer of 1964, when inventories were very heavy. As excess stocks of refined petroleum products were worked off, the gasoline price wars came to an end.

Prices of metals and metal products continued to rise last year, extending the uptrend that began early in 1963. Much of 1965 advance was attributable to higher prices for nonferrous metals, as strong worldwide demand and strikes in major producing countries squeezed domestic supplies. Iron and steel prices as a group were relatively stable; scrap prices fell sharply and prices for steel mill products showed small selective increases. The upswing in business capital outlays continued to push

up prices for most types of nonelectrical machinery. However, because of stability in motor vehicle and electrical machinery prices, the overall index of machinery and equipment prices rose only moderately.

#### Price increases more frequent

One aspect of the rise in wholesale industrial prices over the past year has been the greater frequency of price increases and the lesser frequency of price decreases as compared with other years of the current expansion. This is brought out in table 2.

The data in table 2 are based on 1,418 industrial commodities in the BLS Wholesale Price Index for which continuous series exist back to October 1961. For each of four timespans, frequency distributions of percent changes are presented by size and direction of change for all items and for durables and nondurables separately. Over 80 percent of all industrial items are included. Preliminary October 1965 figures were the most recent detailed data available when the tabulation was made.

Approximately half of the commodities registered some price increase from October 1964 to October 1965, and the proportion was the highest for any of the timespans shown. Increases of 2 percent or less did not change much in relative importance over the entire 4-year period; advances of more than 2 percent—especially

those in excess of 5 percent—became more numerous.

About 30 percent of the commodities showed no change, and 20 percent showed declines from October 1964 to October 1965. The proportion of decreases of 2 percent or less was roughly the same throughout the 4-year period; the proportion of decreases above 2 percent, particularly those greater than 5 percent, declined steadily.

#### Farm and food prices advance

From 1962 to 1964, a downward drift in prices of farm products (fostered by a favorable supply situation), relative stability in wholesale food prices, and only modest increases in retail food prices, made an important contribution to overall price stability. Last year saw a marked change attributable chiefly to sharply higher prices for livestock and meat. On an overall basis, prices at all levels of production and distribution rose rapidly during the first half of 1965. In general, prices changed relatively little during the summer and fall months.

Wholesale market prices for farm products rose nearly 8 percent, seasonally adjusted, from December 1964 to June 1965. From June to November, there was little further net change, but in December, farm prices were again moving higher. As chart 22 shows, the 4½-percent rise in wholesale prices for farm products from 1964 to 1965 was the largest annual increase since 1958. Prices for fruits, vegetables, and grains moved lower last year under the influence of record crop production, but prices of livestock were one-sixth above the 1964 average. In early December, prices of hogs in Chicago were at a 17-year high, nearly double the market price a year earlier.

In the first half of 1965, the rise in processed food prices at wholesale markets did not match the increase for farm products. Unlike farm product prices, however, wholesale food prices continued to move up during the last half of 1965 as processors adjusted to higher raw material costs. For the full year, the advance from 1964 in wholesale food prices—more than 4 percent—nearly equaled that of farm products.

Table 2.—Frequency Distributions of Changes in Wholesale Industrial Prices

Percent change	Total (1418 commodities)				Durable (336 commodities)				Non-durable (586 commodities)			
	Oct. 1961–Oct. 1962	Oct. 1962–Oct. 1963	Oct. 1963–Oct. 1964	Oct. 1964–Oct. 1965	Oct. 1961–Oct. 1962	Oct. 1962–Oct. 1963	Oct. 1963–Oct. 1964	Oct. 1964–Oct. 1965	Oct. 1961–Oct. 1962	Oct. 1962–Oct. 1963	Oct. 1963–Oct. 1964	Oct. 1964–Oct. 1965
10.0% and over.....	2.8	3.0	6.6	6.3	3.0	2.8	7.0	3.2	2.4	3.2	4.4	7.9
5.0% to 10.0%.....	4.0	4.1	6.1	3.4	4.3	5.7	6.6	3.7	3.6	6.6	5.4	9.0
4.0% to 5.0%.....	1.9	4.7	3.3	2.2	2.2	3.8	4.1	3.3	1.5	2.1	2.2	3.1
3.0% to 4.0%.....	3.5	3.2	4.0	0.4	4.5	6.6	3.3	7.7	2.2	2.1	3.4	4.6
2.0% to 3.0%.....	5.1	4.8	6.6	7.6	6.3	5.7	8.9	2.1	3.4	2.9	3.4	7.0
1.0% to 2.0%.....	6.7	7.3	8.7	8.4	9.9	11.1	8.9	11.8	7.1	3.2	7.1	6.1
0.0% to 1.0%.....	9.7	8.5	10.0	8.0	10.3	10.9	12.2	9.7	9.0	4.1	7.0	4.4
0.....	33.1	24.3	33.3	29.8	30.5	30.8	25.7	22.3	44.0	44.0	48.1	48.4
–0.0% to –1.0%.....	4.5	4.6	5.4	5.3	6.3	4.5	6.5	6.5	4.8	4.8	3.9	4.9
–1.0% to –2.0%.....	4.2	3.9	3.8	3.2	5.4	4.0	4.9	4.0	2.5	3.8	3.4	3.2
–2.0% to –3.0%.....	3.3	2.7	1.8	2.3	2.0	2.3	1.6	2.1	3.7	3.2	2.2	1.9
–3.0% to –4.0%.....	2.0	2.2	2.7	1.8	2.2	2.1	2.1	2.2	1.7	2.4	3.2	1.4
–4.0% to –5.0%.....	1.9	2.0	1.5	1.6	1.8	2.7	1.8	1.9	2.0	1.3	1.7	1.2
–5.0% to –10.0%.....	5.6	4.7	3.6	3.1	5.6	4.1	3.8	2.5	3.6	5.6	4.5	3.9
–10.0% and over.....	5.6	3.3	2.5	2.5	4.9	1.1	1.9	3.8	6.6	7.6	4.4	1.9
Total.....	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Increases.....	33.7	29.3	45.8	50.3	40.4	48.6	51.8	55.4	29.0	27.3	34.0	42.1
No change.....	33.1	24.3	33.3	29.8	30.5	30.8	25.7	22.3	44.0	44.0	48.1	48.4
Decreases.....	28.2	24.0	21.5	19.9	29.1	20.6	22.5	19.3	27.0	28.7	17.9	16.5
Total.....	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

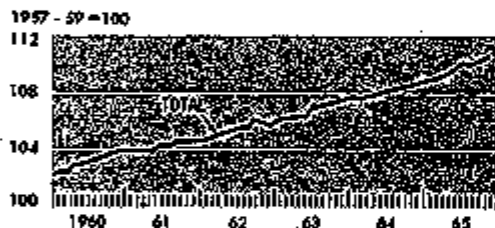
NOTE.—Details may not add to total due to rounding.

Sources: Basic data, BLS. Calculations by ORE.

Prices paid by consumers for food, at both grocery stores and restaurants, reflected the rise in wholesale prices. From January to July, food-at-home prices in the consumer price index rose 4 percent, seasonally adjusted, chiefly as a result of a 10-percent increase in the meat, poultry, and fish index. With meat prices stabilizing after mid-summer, the index leveled out and toward the end of the year declined slightly. For the year as a whole, food prices were about 2½ percent above the 1964 level, as compared with increases ranging from 1 to 1½ percent in the preceding 4 years.

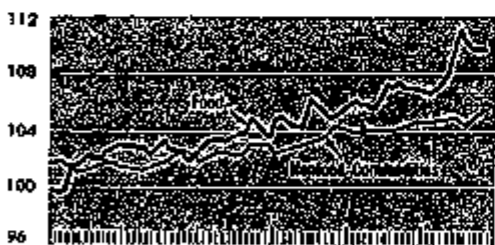
CHART 24  
**Consumer Price Index Advanced to a New Peak During 1965**

*Rise exceeded increases in other recent years*

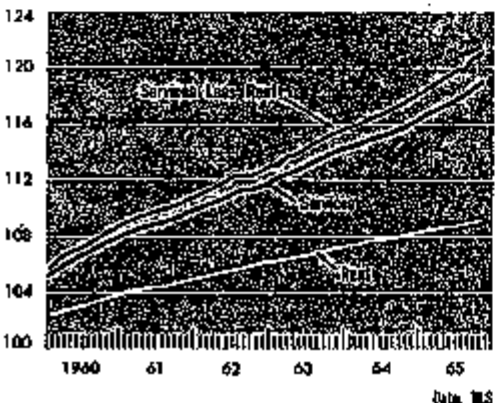


*Food prices rose sharply in first half of 1965*

*Nonfood commodity prices showed a small advance*



*Rise in service prices continued*



### Nonfood consumer prices mixed

Consumer prices for commodities other than food rose only two-thirds of 1 percent from 1964 to 1965, the smallest increase since 1961. The mid-year reduction in Federal excise taxes on automobiles, appliances, and other consumer items and price reductions for durable goods not associated with the tax cut offset increases in apparel and fuel.

In automobile markets, prices were lower despite record sales. Last year's 2½-percent reduction in new car prices, the fourth successive annual decline, brought prices of new automobiles nearly 5 percent below the 1959 peak. Seasonally adjusted data show a definite two-stage reduction within the year. Prices fell about 2½ percent after the tax cut and somewhat less in the fourth quarter. Used car prices (not directly influenced by the tax reduction), which rose one-fifth from 1960 to 1964, declined rather steadily throughout 1965. Although average prices for the year were down less than 1 percent from 1964, yearend quotations were about 4 percent under the figures a year earlier. Prices for household durable goods fell for the seventh straight year; of the 1½-percent decline from 1964, about one-half was attributable to the tax cut.

The long upward trend in service prices continued last year, with the average advance, 2½ percent, slightly above the annual increases from 1961 to 1964. Gains were fairly general and, as in recent years, were smaller for rent than for most other services.

### Financial Developments

Last year's expansion in economic activity was accompanied by a marked increase in the pace of credit demands. Most of the increase came from corporations, but consumers and State and local governments also stepped up their borrowing; the Federal Government made only minor net demands on money and capital markets. The supply of funds available to meet the rising need for credit accommodation showed increasing signs of stringency in the second half of the year, and interest rates moved moderately higher. Until

very late in the year, continued pressure by the Administration had been an important influence in keeping bank rates on short-term business loans relatively stable. In December, after the Federal Reserve raised the discount rate, the rise in interest rates of most types accelerated.

### Monetary policy less easy

Last year, the Federal Reserve subjected bank reserve positions to pressure somewhat greater than in 1954. During each month of 1965, borrowed reserves were substantially higher than a year earlier; total bank reserves increased \$0.8 billion, not fast enough to support the rise in total bank credit. These higher reserves were provided by increased bank currency holdings and by a record volume of Federal Reserve purchases of U.S. Government securities, which were \$4 billion last year as compared with \$3½ billion in 1964.

Credit expansion by commercial banks in 1965 reached a record of \$26 billion, as compared with \$18 billion and \$21 billion in 1963 and 1964 respectively. Business loans rose markedly above the 1964 pace, \$11 billion as compared with \$6 billion. The increase was particularly sharp in the first quarter, when inventory accumulation was very large and just before the voluntary guidelines on foreign lending were adopted. The rate of increase in business loans slackened in the second half to \$4½ billion at an annual rate. Banks also increased their lending to consumers and their purchases of State and local government securities, but real estate lending was little changed.

With reserve positions somewhat tighter and loan demands heavy, bank holdings of U.S. Government securities declined very sharply in 1965; they dropped \$4 billion as compared with less than \$1 billion in 1964. The decline bottomed out at the end of the third quarter, and holdings of Governments rose slightly in the last quarter. These increases in bank assets were matched on the liability side by a \$23½ billion increase in deposits. Demand deposits were up \$5 billion as compared with a gain of \$4½ billion in 1964.

Time deposits rose more sharply, \$20½ billion as against \$15 billion in 1964, and Government deposits declined. Since reserve requirements are lower for time deposits than for demand deposits, this sharp rise contributed to an expansion in bank credit.

#### Corporate investment higher

A sharp rise in the investment and working capital requirements of non-financial corporations outstripped a substantial increase in their internal funds last year. Consequently, corporations stepped up their external financing and reduced their holdings of liquid assets.

Fixed investment expenditures by nonfinancial corporations in 1965 were more than \$9 billion above the 1964 total. Corporate inventories rose \$6 billion in 1965 as compared with an

increase of \$4½ billion in 1964. The peak in accumulation was reached in the first quarter, after which inventory investment tapered off.

Direct investment abroad by corporations in the first three quarters of 1965 was \$3½ billion as compared with \$2½ billion in all of 1964. The greatest part of the increase occurred in the first half of 1965; the reduction in these outlays as the year progressed reflected the efforts of firms to cooperate in the program to improve the balance of payments.

Before-tax profits of nonfinancial corporations rose 15½ percent above 1964 to \$62 billion; the reduction in Federal taxes contributed to a relatively greater increase in after-tax profits. Since dividend payments did not keep pace with the increase in earnings, undistributed profits rose \$4½ billion

or 28 percent over the previous year. Net cash flow—the sum of undistributed profits and capital consumption allowances—increased \$6½ billion in 1965 as compared with a \$5 billion advance in 1964.

With internal funds rising less than investment and working capital needs, new bank loans increased \$6 billion from 1964 to 1965. Bond issues rose to \$6½ billion as compared with \$4 billion in 1964. Retirements of stock issues about equaled new flotations, in contrast to a net issue of \$1½ billion in 1964.

In 1965, liquid assets declined at about the same rate as in 1964. Within this total, U.S. Government securities, demand deposits, and currency decreased, and time deposits rose.

#### Consumer debts and assets up

Mortgage financing by consumers in 1965 was little different from 1964 because of the comparative stability in single-family home construction. However, the sharp rise in purchases of consumer durable goods was accompanied by a large increase in the use of credit. Consumer installment credit outstanding increased \$7½ billion in 1965, after an accretion of \$5½ billion in 1964. Automobile paper accounted for almost half of the 1965 advance.

In the fourth quarter of 1965, the ratio of installment debt to disposable personal income stood at 13.7 percent, as compared with 12.9 percent a year earlier. Nevertheless, the most recent ratio did not appear high when gauged by postwar trends. The ratio has risen throughout the postwar period, as households and individuals have made increased use of credit to finance their purchases and as average loan maturities have lengthened.

Consumers' investment preferences in 1965 featured increased emphasis on bank time deposits and less on savings and loan shares. Consumers stepped up their investment in mutual funds, about in line with the increase in total stock market purchases, but decreased their holdings of other types of stocks.

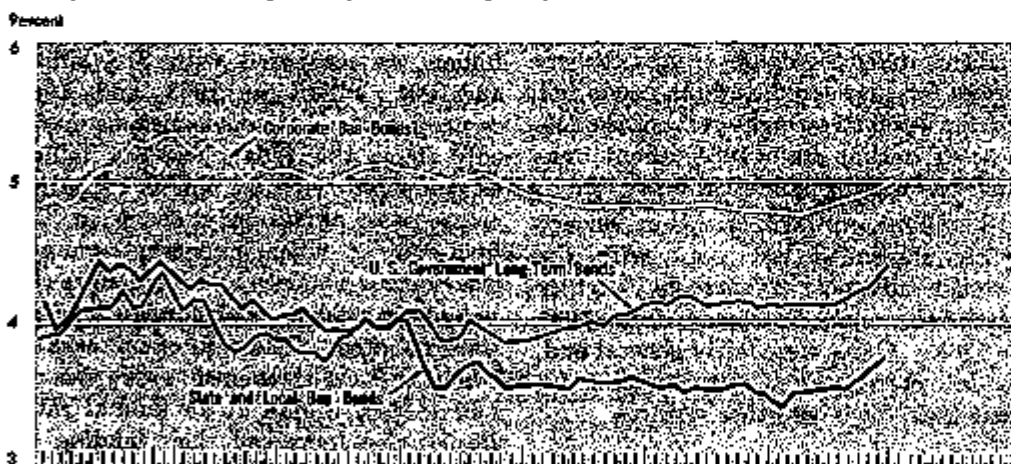
#### Government borrowing down

The improvement in the fiscal position of the Federal Government in 1965 was reflected in a reduction in Government borrowing. Last year, net borrowing by the Federal Government

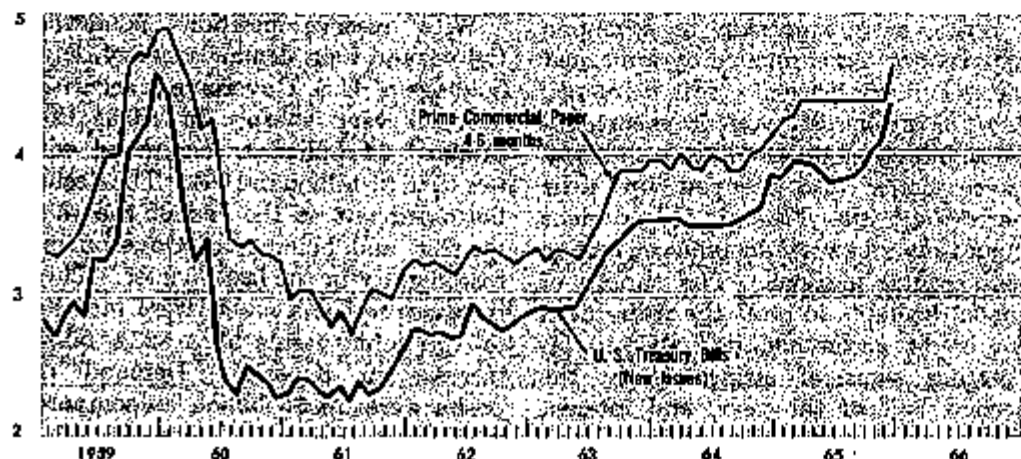
CHART 25

### Interest Rates

Long-term rates moved up, mainly in the latter part of 1965



and short-term rates rose, particularly in December



Data from Moody's &amp; I.B.E.

totaled a little over \$1 billion, in contrast to \$6 billion a year earlier. Within 1965, however, movements in Federal borrowing did not match the wide swings in the Federal fiscal position. During the first half, when the Government ran a substantial surplus, its cash balances were built up. These were permitted to run down in the second half as Federal expenditures exceeded receipts.

State and local governments increased their borrowing moderately, from \$10½ billion in 1964 to \$11 billion in 1965.

#### *Interest rates rise*

Over most of the expansion that started in early 1961, short-term interest rates moved irregularly higher while long-term rates were roughly stable. Monetary policy encouraged a rise in short-term rates in order to dampen the outflow of capital abroad but was oriented toward stable long-term rates in order to facilitate domestic economic expansion. The fact that corporate internal funds rose more rapidly than investment requirements was also important in fostering stability in long-term borrowing costs.

In 1965, the monetary authorities shifted somewhat from a policy of ease, and the rise in corporate investment requirements started to outstrip the increase in internal funds. Interest rates began to edge up, mainly in the latter part of the year. On December 6, the Federal Reserve raised the discount rate from 4 to 4½ percent and increased the maximum rate on time deposits having a maturity of 30 days or more to 5½ percent.

Short-term rates and long-term yields moved sharply upward throughout December. For the month as a whole, prime commercial paper moved 48 basis points above the December 1964 rate of 4.17 percent. Over the same period, new 3-month Treasury issues rose from 3.86 percent to 4.37 percent, and yields on long-term Government bonds rose from 4.14 percent to 4.43 percent.

#### **Production Expansion**

*(Continued from page 16)*

#### *Comparison with 1953-60*

When growth rates from 1960 to 1965 are compared with those for the

two periods from 1953 to 1960, it is clear that differences are most pronounced for consumer durables, producers' durable equipment, and Federal Government expenditures. The rate for consumer expenditures other than durables was moderately higher, but the rate for State and local government purchases was somewhat lower.

These shifts in markets underlie the changes in output by type of product. Durable goods output, with a growth rate of 6½ percent since 1960, has increased far more rapidly than it did from 1953 to 1957 or from 1957 to 1960. As compared with the 1953-60 period, average growth rates since 1960 have accelerated for each of the other three types of products, but not as much as in the case of durable output. The differences over the two periods are least for service output and greatest for structures.

#### **Balance of Payments**

*(Continued from page 18)*

of 1965, began to rise because of increased expenditures in Southeast Asia. Increased military sales offset much of the rise in expenditures.

U.S. Government grants and capital outflow, net of repayments, remained close to the \$3.6 billion level of the preceding 2 years. The small advance in outflow in 1965 was offset by increased repayments, which included a large advance repayment by France in the third quarter.

#### **Private Capital Outflows**

The substantial decline in U.S. private capital outflow in 1965 was primarily responsible for the improved balance-of-payments position of the United States. Through September, the outflow was reduced to \$3.6 billion at an annual rate, well below the 1963 and 1964 levels of \$4.5 and \$6.5 billion respectively.

Principally through large net liquidations in the second quarter, bank loans shifted from an increase of \$2.5 billion in 1964 to a decrease of over \$0.1 billion (after seasonal adjustment) in the 9-month period through September 1965. Bank credits abroad remained well within the guideline of a

\$0.5 billion increase suggested for the full year 1965.

Nearly \$0.5 billion in funds invested abroad by nonbank corporations were repatriated in the first 9 months of 1965. This contrasts with the extraordinary outflow of over \$0.9 billion in all of 1964 and represents a \$1.4 billion improvement over the period. The liquidation occurred largely in the first two quarters of the year.

U.S. direct investments abroad were exceptionally high in the first half of the year before investment plans could be changed in response to the President's program. Although direct investments declined sharply in the third quarter, the 1965 total will probably be substantially higher than the 1964 level of \$2.4 billion.

Through September 1965, purchases of new issues of foreign securities amounted to \$0.9 billion, seasonally adjusted, as compared with \$1.1 billion for all of 1964. The 1965 purchases included a \$160 million issue by the International Bank, the proceeds from which were placed in long-term time deposits so that they did not immediately affect liquid liabilities. Most of the other new issues were Canadian. Since the introduction of the Interest Equalization Tax in July 1963, there have been few issues sold here by countries subject to the tax, but in the first three quarters of 1965, the amount involved rose to more than \$100 million.

#### **Other Major Transactions**

U.S. receipts from income on investment continued the strong upward trend of recent years. The increase in income on investment in 1965 may have reflected, in addition to the expanded level of direct investment abroad, the reduction in the U.S. corporate income tax rate, changes in the German tax system, and, early in the year, some concern about the balance of payments situation of the United Kingdom.

A major change in foreign long-term investment in the United States resulted from large net sales by foreigners of U.S. corporate securities in the second and third quarters, reflecting in part conversions by the British Government. Total net sales amounted to nearly \$0.5 billion in 1965, as compared with \$0.1 billion in 1964 and with net purchases of \$0.3 billion in 1963.